No. 86 1802

Supreme Court, U.S.
FILED
MAY 8 1987
JOSEPH F. SPANIOL, JR.
CLERK

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1986

AMERICAN SAVINGS AND LOAN ASSOCIATION,
a California corporation,
Petitioner,
vs.
MORGAN GUARANTY TRUST COMPANY OF NEW YORK,
a New York corporation,
Respondent.

AMERICAN SAVINGS AND LOAN ASSOCIATION,
a California corporation,
Third Party Plaintiff,
vs.
CHASE MANHATTAN BANK, N.A.,
Third Party Defendant.

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Whether the final payment rule of the Uniform Commercial Code is subject to judicial exceptions?

LIST OF ALL PARTIES TO THE PROCEEDING

The caption of the case contains the names of all parties.

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MORGAN GUARANTY TRUST COMPANY OF NEW YORK,
a New York corporation,
Plaintiff and Appellant,
VS.
AMERICAN SAVINGS AND LOAN ASSOCIATION,
a California corporation,
Defendant and Appellee.

AMERICAN SAVINGS AND LOAN ASSOCIATION,
a California corporation,
Third Party Plaintiff,
VS.
CHASE MANHATTAN BANK, N.A.,
Third Party Defendant.

PETITION FOR WRIT OF CERTIORARI

REPORTS OF OPINIONS DELIVERED IN THE COURTS BELOW

Morgan Guaranty Trust Co. v. American Savings & Loan Assoc., 605 F.Supp. 1087 (C.D. Cal. 1985).

Morgan Guaranty Trust Co. v. American Savings & Loan Assoc., 804 F.2d 1487 (9th Cir. 1986) (majority opinion); 804 F.2d 1487 (dissenting opinion).

JURISDICTIONAL STATEMENT

The judgment sought to be reviewed is the judgment of the Ninth Circuit Court of Appeals filed on November 26, 1986, Judges Fletcher and Nelson voting in the majority and Judge Hall dissenting. On April 6, 1987, the Ninth Circuit Court of Appeals filed an Order denying petitioner's petition for rehearing.

On April 17, 1986, the Court of Appeals granted petitioner's motion for a stay of mandate, without bond, pending this Court's disposition of this Petition for Certiorari, conditioned on petitioner filing this Petition by May 17, 1987. This Court has jurisdiction to review the judgment in question by writ of certiorari pursuant to 28 U.S.C. § 1254(1).

UNIFORM COMMERCIAL CODE STATUTE INVOLVED IN THIS CASE

The final payment rule is set forth in Section 3-418 of the Uniform Commercial Code, as follows:

> "Except for recovery of bank payments as provided in the Article on Bank Deposits and Collections (Article 4) and except for liability for breach of warranty on presentment under the preceding section, payment or acceptance of any instrument is final in favor of a holder in due course, or a person who has in good faith changed his position in reliance on the payment."

STATEMENT OF THE CASE AND STATEMENT OF FACTS

The material facts of this case are undisputed, and are stated here by reference to the facts set forth in the opinions below.

On July 8, 1982 American Savings and Loan Association ("American") purchased for value, without notice and in good faith two Manville Corporation bearer notes due and payable September 2, 1982 at Morgan Guaranty Trust Company ("Morgan"), the payor bank on the notes, each note having a face value of $5 million. The notes were held for American by Chase Manhattan Bank, N.A. ("Chase") until maturity. (605 F.Supp. at 1088).

On August 26, 1982, one week before the notes matured, Manville filed a Chapter 11 petition in bankruptcy. Morgan, which held several Manville accounts, immediately instituted special procedures to process Manville notes and checks. The procedures were designed to ensure proper disposition on each and every check presented in compliance with the applicable New York Clearing House rules, and to involve bankruptcy counsel in all payment decisions. In the days following the Chapter 11 filing, Morgan received into these channels hundreds of items drawn by Manville. Many were timely returned unpaid. However, many other items were paid by Morgan, despite Manville's bankruptcy and despite the fact that payment caused an overdraft. (*Ibid.*)

On September 2, 1982, the maturity date, acting without specific instructions from American, Chase presented the Manville notes upon the payor Morgan through the New York Clearing House 2:00 a.m. exchange. At the time of presentment, the aggregate of available funds in all of Manville's accounts was less than $2 million.

When the Manville notes passed through the New York Clearing House check exchange they became subject to the Clearing House rules. Under the rules, notes presented through the 2:00 a.m. exchange are subject to provisional settlement at 10:00 a.m., which provisional settlement can only be revoked if the payor takes action to

return the items by 3:00 p.m. that day. Rule 6b, Rules Governing the Return of Items Received Through the Exchange of the New York Clearing House. By the time bankruptcy counsel was consulted on these notes and decided to dishonor them, the 3:00 p.m. deadline for dishonoring such notes was well past. (605 F.Supp. at 1089).

Morgan does not dispute that its failure to revoke the provisional settlement timely constitutes final payment of the Manville notes by the payor bank under Section 4-213 of the Uniform Commercial Code, and Morgan agreed below that when American took the notes on July 8, 1982, it became a holder in due course under Section 3-302 of the Uniform Commercial Code. (605 F.Supp. at 1091).

After payment to American, the payor Morgan demanded repayment of the money, first from Chase as American's agent and then from American itself. American refused to return the payment. (605 F.Supp. at 1089). Morgan then filed a complaint against American asserting several theories of recovery. The basis for jurisdiction in the District Court was diversity of citizenship. American filed a third-party complaint against Chase seeking indemnity if American was found liable on a promise by Chase, acting as its agent, to return the money to Morgan. Cross-motions for summary judgment were filed by American and Morgan and Chase filed a motion to dismiss Morgan's complaint for failure to state a claim. All motions were presented and heard together.

The District Court granted American's motion for summary judgment. (605 F.Supp. at 1094). The District Court found that all of Morgan's claims were barred by the final payment rule embodied in Section 3-418 of the Uniform Commercial Code. (605 F.Supp. at 1090-93). The majority opinion of the Court of Appeals reversed the

District Court's grant of summary judgment in favor of American, and remanded with instructions to enter summary judgment for Morgan on its claims for unjust enrichment and money had and received. The majority held that the final payment rule, which bars recovery of payment by a payor from a holder in due course, is subject to expectation where the holder in due course acquires notice of the maker's bankruptcy after the taking, but before presentment, of the instrument and therefore has a reduced "expectation of finality". (804 F.2d at 1496). Judge Hall dissented from the majority's opinion, concluding that "[T]he goal of finality to which section 3-418 is directed is [not] at all linked to any expectations of finality of a party to the transaction. The principle is inextricably linked to the expectations not only of the instant parties but to the millions of future parties whose conduct must conform to section 3-418 and who must know its limits to conform to its guidelines." 804 F.2d at 1501.

ARGUMENT

I

INTRODUCTON

American petitions for certiorari to the majority opinion below in order that this Court restore stability to the final payment rule. The dissenting opinion notes that the opinion of the majority destablizes the final payment rule by carving out the first judicial exception to it, and raises the alarm that it will destroy the predictability essential to the smooth functioning of our nation's banking system. (804 F.2d at 1501-03). Courts particularly should not intrude into an area which the Commercial Code drafters reserved to themselves. Otherwise, the exceptions will

become the rule, and the Clearing House rules will be rendered "mere verbiage". (804 F.2d at 1504).

The final payment rule furthers the underlying goal of the Uniform Commercial Code to safeguard "the interest of society in an orderly banking system, with the rights and liabilities of participants in the world of finance spelled out in advance." 1 Anderson, *Uniform Commercial Code*, Section 1-102:46[1] (3d Ed. 1981). The majority's opinion disrupts that goal.

The majority candidly recognizes that no court has previously questioned the final payment rule, and that its decision was most difficult: "Although we reverse, we acknowledge that this is a close case and that the key issue is one of first impression." (804 F.2d at 1500). The points addressed by the strong dissent are significant, as they challenge the propriety of courts to intrude at all into the final payment rule by grafting exceptions to the broad statutory rule. No other *post*-UCC decision has permitted a judicial exception to the final payment rule, and all of the decisions of the last three decades have upheld the rule. Indeed, the majority opinion is directly in conflict with the recent decision of the Second Circuit Court of Appeals which upholds the rule by affirming the District Court's denial of recovery to a payor bank in *Northern Trust Co. v. Chase Manhattan Bank*, 748 F.2d 803 (2d Cir. 1984).

The question presented for review does not simply address the local law of New York or any single state. The decision of the majority is not limited only to these litigants or to one Circuit. Its impact will be felt in each of the 49 states which have adopted the final payment rule of the Uniform Commercial Code.

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[1]All citations hereafter are to the Uniform Commercial Code.

Given that the issue presented by this case has national significance, that it has never been presented before, and that it concerns commercial practice in virtually every state of the union, review should be granted by this Court. The majority below recognizes the significance of this Court's views on the subject, having granted a stay of mandate on its decision pending this Court's disposition of certiorari.

II

THE FINAL PAYMENT RULE OF THE COMMERCIAL CODE IS ESSENTIAL TO THE SMOOTH FUNCTIONING OF OUR NATION'S BANKING SYSTEM AND CANNOT BE SUBJECT TO JUDICIAL EXCEPTIONS.

The final payment rule bars recovery of restitution for payments made to a holder in due course:

> "Except for recovery of bank payments as provided in [Article 4], and except for liability for breach of warranty on presentment under the preceding section [3-417], payment or acceptance of any instrument is final in favor of a holder in due course, or a person who has in good faith changed his position in reliance on the payment." Section 3-418.

The Code drafters note the broad policy of this rule is to establish repose: "[I]t is highly desirable to end the transaction on an instrument when it is paid rather than reopen and upset a series of commercial transactions at a later date. . . ." Official Comment 1 to section 3-418. *See also*, 6 R. Anderson, *Uniform Commercial Code*, Section 3-418:4, at 412 (3d Ed. 1984): "UCC Section 3-418 is predicated upon the need for finality and not upon any outdated concept that the drawee bank can carefully

examine checks for forgery." *Demos v. Lyons*, 376 A.2d 1352, 1355, 151 N.J. Super. 489 (1977): "The final payment rule" is a "rule of law" whose "rationale is repose. Establishing the finality of a payment tends to assure stability in people's affairs."

Courts have emphasized this rule of repose as well as its rationale, and regularly have cautioned against weakening it:

> "In New York City alone, the average daily exchange at the New York Clearing House amounts to $5,642,306,382.51. . . . [I]n a functional economy paper is king.
>
> "This fluidity of exchange is made possible by the country's 'banking system.' It provides the machinery and the personnel which makes the transfer of funds possible and workable.
>
> * * *
>
> "The Court is aware of the fact that a payor bank is placed in a rather precarious position. It must act and act quickly under rather hectic conditions to protect itself against incurring substantial liabilities. However, the integrity of the entire system and of commercial paper itself requires that someone bear a risk. The UCC has quite logically placed the risk upon the obvious party [the payor bank]." *Met Frozen Foods Corp. v. National Bank*, 89 Misc. 2d 1033, 393 N.Y.S.2d 643, 644, 645, 647 (1977). *See also, Marine Midland Bank v. Umber*, 410 N.Y.2d 25, 27 (1978).

The rationale for the refusal to relieve a drawee or payor bank of its failure to comply with time limits for returning dishonored items is critical to our banking

system and is found in the very nature of the collection process. After a customer deposits a check for "credit" to his account, each "collecting bank" (Section 4-105) in the chain gives provisional credit to its customer before forwarding on the item, which provisional credit typically becomes final after the passage of a specified time for the collecting bank to learn whether the item has been dishonored. *No notification at all is received by the collecting or depository bank that the item has been paid; rather, our banking system assumes payment* in the absence of notice to the contrary *and the provisional credit becomes available for withdrawal as a matter of right* after expiration of whatever "hold" is placed on the item by the depository bank. *See, North Park National Bank v. Bankers Trust Co.*, 572 F.Supp. 524, 525-526 (S.D.N.Y. 1983).

What the majority opinion below fails to apprehend is that, irrespective of what may occur in any particular case, the strict adherence to time deadlines must be enforced because transactions are closed, and rights and liabilities are fixed, a million times a day, when the deadlines have passed without notice of dishonor. It is the assumption of payment, rather than nonpayment, by passage of time on which our system rests. The majority opinion would shake that foundation.

The New York Annotations to the final payment rule have made it crystal clear that the *only* exceptions to the rule are those specified by the statute, and that any holder in due course (except one who falls within the stated exceptions) is protected from repayment:

> "... The Code makes payment final in favor of *any* holder in due course or any person who has in good faith changed his position in reliance on the payment,

subject to the exceptions stated." New York Annotations to section 3-418. (Emphasis added.)[2]

Aside from the policy hurdles faced by the majority, it cannot overcome the fact that the final payment rule of Section 3-418 has displaced Section 1-103 of the Code. Therefore, the "common law" of mistake cannot serve as the basis for judicial exceptions to the final payment rule. As the Code drafters noted:

> "... The drawee ... retains common-law rights, *e.g.*, to recover money paid under a mistake (Section 1-103) in cases where the payment is *not* made final by Section 3-418." Official Comment 8 to Section 4-403 (emphasis added).

The leading commentators in the field also have concluded that the final payment rule displaces a restitutionary action under Section 1-103 to recover money paid by mistake:

> "... *3-418 blocks the drawee's restitutionary action against a presenter* [when] (1) There ... [has] been 'payment or acceptance' (i.e., *final payment* as defined in 4-213) [and] (2) It ... [was] *in favor of (a) a holder in due course....*" White & Summers, *Uniform Commercial Code,* (2d ed. 1980) at p. 610. (emphasis added).

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[2]As a general rule, it is axiomatic that exceptions to statutory coverage are to be strictly construed. (*Israel-British Bank v. FDIC*), 536 F.2d 509, 513 (2nd Cir. 1976), and courts may not read additional exceptions into a statutory scheme where it is clear the statute was intended to operate broadly. This is especially so where exceptions to a broad statutory provision are set forth with specificity in the statute itself. *Consumer Products Safety Commisssion v. GTE Sylvania,* 447 U.S. 102, 100 S.Ct. 2051, 64 L.Ed.2d 766 (1980).

Official Comment 5 to Section 3-418 as well requires obedience to the deadlines as the price of recovering restitution:

> "[The final payment rule] is . . . limited by the bank collection provision (Section 4-301) permitting a payor bank to recover a payment improperly paid if it returns the item or sends notice of dishonor within the limited time provided in that section. *But notice that the latter right is sharply limited in time, and terminates in any case when the bank has made final payment, as defined in Section 4-213.*" (Emphasis added).

All *post*-UCC judicial authority also bars restitutionary action against holders in due course. *See, e.g., Northern Trust Co. v. Chase Manhattan Bank,* 582 F. Supp. 1380, 1386 (S.D.N.Y.), *aff'd.* 748 F.2d 803 (2d Cir. 1984); *Bryan v. Citizens National Bank in Abilene,* 628 S.W.2d 761, 763-64 (Tex. 1982) (the Texas Supreme Court holding that Section 3-418 makes payment to a holder in due course final "so as to cut off all rights to revoke the payment", including common-law restitution rights); *Lowe's of Sanford, Inc. v. Mid-South Bank and Trust Co.,* 260 S.E.2d 801, 802, 44 N.C. App. 365 (1979), (holding that "acceptance" is final in favor of a holder in due course under Section 3-418); *Bank Leumi Trust Company of New York v. Bank of Mid-Jersey,* 499 F.Supp. 1022, 1027 (D.N.J. 1980) (holding that common-law restitution based upon mistake is precluded by the final payment provisions of the Uniform Commercial Code); *Maplewood Bank and Trust Co. v. F.I.B., Inc.,* 362 A.2d 44, 46, 142 N.J. Super. 480 (1976) (stating that Section 3-418 bars recovery of proceeds erroneously paid by a bank, but concluding that the payee was neither a holder in due course nor a good faith relier); *Aetna Life and Casualty*

Co. v. Hampton State Bank, 497 S.W.2d 80, 86 (Ct. Civ. App. Tex. 1973) ("Under Section 3-418, common law liability is excluded and the controlling question is whether payment of the check by Northwest to Hampton was 'final'.")

The majority's opinion is directly in conflict with the opinion of the Second Circuit Court of Appeals affirming the District Court decision in *Northern Trust Company v. Chase Manhattan Bank, N.A., supra.* The District Court in *Northern Trust* gave judgment against the payor bank, expressly holding the final payment rule bars recovery in favor of a holder in due course on a cause of action for money paid by mistake.

> "Section 3-418 of the Uniform Commercial Code provides in relevant part that 'payment or acceptance of any instrument is final in favor of a holder in due course. . . .' "
> "This Section itself requires judgment for Chase [the holder]."
> "Chase is a holder in due course. . . . Chase took the check for value, in good faith, and without notice of any defense-the requirements specified in U.C.C. Section 3-302(1)."
>
> * * *
>
> "The final payment rule embodied in U.C.C. § 3-418 bars any recovery in this action by Northern [the drawee]." 582 F.Supp. at 1385.

The Second Circuit affirmed the judgment "for the reasons stated in Judge Wyatt's thorough opinion," expressly approving his holding "that the final payment rule, *see* N.Y. Uniform Commercial Code § 3-418" barred recovery on all theories. 748 F.2d at 804. *See, also,*

Admiralty Leather Corp. v. Manchester Modes, Inc., 422 F.Supp. 387, 389 (S.D.N.Y. 1976).

There is no *post*-UCC case which holds or even infers tht a bank may recover money paid by mistake to a holder in due course. Morgan cannot rely on language in the District Court decision in *Bank Leumi Trust Co. v. Bally's Park Place, Inc.*, 528 F.Supp. 349 (S.D.N.Y. 1981), which states that Section 3-418 does not bar restitution of money paid by mistake. The proposition is true so long as no holder in due course is involved in the case, as the *Bank Leumi* court makes clear early in its opinion:

> "Concepts having to do with bona fide holders of negotiable paper in due course without notice are not involved in this litigation. See, New York U.C.C. § 3-302." *Id.* at 350, n.1.

Throughout this litigation, Morgan also has misstated the decision of the court in *Great Western Bank & Trust v. Nahat*, 138 Ariz. 260, 674 P.2d 323 (Ariz. App. 1983). The court in *Nahat* did not award restitution to the payor bank nor did it determine that the payee was a holder in due course. Indeed, the purpose of the Arizona appellate court in remanding was for the trial court to determine whether Nahat was a holder in due course or not.

Another case often cited by Morgan is *National Savings and Trust Co. v. Park Corp.*, 722 F.2d 1303 (6th Cir. 1983), where the court states that Section 3-418 is "basically a codification of restitutionary principles." *Id.* at 1305. However, after acknowledging that the final payment rule does indeed bar restitutionary recovery for banks, the court in *National Savings* engaged in a factual analysis of whether Park Corporation was either a holder in due course or a good faith relier. *Id.* at 1306.

Finally, *Farmer's & Merchant's Bank v. Universal C.I.T. Credit Corp.*, 4 Utah 2d 155, 289 P.2d 1045 (1955) provides no support for Morgan's position. It is a *pre-Code* case, decided before the adoption of Section 3-418 which displaced the common law. The case is not concerned with whether the payee of the check was a holder in due course or not, and the facts do not make clear whether the payee learned his checks were NSF at the time he took them or thereafter.

III

THE FINAL PAYMENT DOCTRINE, AND ITS RATIONALE OF PREDICTABILITY IN COMMERCIAL TRANSACTIONS, IS NOT LIMITED ONLY TO MISTAKES INVOLVING FORGERIES, OVERDRAFTS OR STOP ORDERS

The majority below claims "two major differences" exist between this case and all of the other cases that have gone before: "First, American had notice of the problem with the instrument. Second, the problem was bankruptcy of the maker, not forgery, insufficient funds or a stop order." (804 F.2d at 1495).

Both of these are distinctions without a difference. The first point — *after*-acquired notice — has already been considered by the Code drafters and the cases and rejected as being without significance:

> "Notice, in order to prevent one from being a . . . holder in due course under the . . . Commercial Code, means notice at the time of the taking or at the time the instrument is negotiated, and not notice arising subsequently. The time when value is given for the instrument is decisive. The moment value is given

> without notice the status as a holder in due course generally is definitely and irrevocably fixed."

Sullivan v. United Dealers Corp., 486 S.W.2d 699, 701 (Ky. Ct. App. 1972). *See, also, Weast v. Arnold*, 299 Md. 540, 474 A.2d 904, 916 (1984); *McCook Cty. Nat. Bank v. Compton*, 558 F.2d 871, 876 (8th Cir. 1977), and cases cited thereat.

The Code drafters also recognized that even a holder in due course who presents with "notice of the problem" is protected. As the majority opinion concedes, "*But see* section 3-417, comment 4, suggesting that, in absence of bad faith, a holder in due course that knowingly presents a forged instrument is entitled to keep money mistakenly paid on it." (804 F.2d at 1496).

The second "distinction" cited by the majority — "The problem was bankruptcy of the maker, not forgery, insufficient funds or a stop order" — has even less vitality. Knowledge of a maker's bankruptcy and a maker's stop order are simply two of the "four legals" dealt with by the Commercial Code (Section 4-303) and have the identical impact upon a payor bank's right or duty to pay an item or to charge its customer's account for the item. White & Summers, *Uniform Commercial Code*, (2d ed. 1980), at p. 692.

The majority opinion, sensitive to the "floodgates" attack leveled by the dissent, urges that exceptions to the final payment rule will be narrowly limited, saying, "The vast majority of cases that implicate Section 3-418 involve forgeries, insufficient funds or stop payment orders. They understandably are governed by the final payment rule." (804 F.2d at 1498). However, the official comments to Section 3-418 make it clear that the statute applies not only to forgeries, insufficient funds or stop payment

cases, but that it applies as well to bar recovery of "*any other payment* made *in error* as to the state of the drawer's account." Official Comment 2 to Section 3-418. (Emphasis added). There simply is no room left for the majority's exception for Morgan's error here.[3]

In seeking to achieve an "equitable" result, the majority has forgotten that the Code draftsmen weighed and balanced the respective equities of a presenter and a payor under different fact situations. Official Comment 4 to Section 3-417 evidences that the code "recognizes and deals with competing equities of parties . . . paying instruments . . . and those . . . receiving payment."

It must be recalled that the battle in this case is not between a holder in due course and the bankrupt. The competition here pits the equities of the holder in due course against those of a payor who by his own fault pays an instrument he could have dishonored, and it further pits that battle in circumstances where *both* the presenter and the payor have the same knowledge at the time of presentment and payment. A holder in due course enters this battle with considerable equities by virtue of his "due course" status alone. As Lord Mansfield stated: "But it can never be thought unconscientious in the defendant to retain this money, when he has once received it upon a bill of exchange, endorsed to him for a fair and valuable consideration, which he had bona fide paid, without the least privity or suspicion of any forgery". *Price v. Neal*, 3

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[3]Indeed it is questionable whether Morgan's $10 million payment was "in error", since Morgan conceded below that it was aware, from August 26 on, of Manville's bankruptcy. For purposes of this petition, American concedes that American's payment was made by Morgan "in error" as to the state of Manville's account and the availablity of funds after bankruptcy.

Burr. 1352, 97 Eng.Rep. 871, 872 (1762). *Accord*, Official Comment 3 to Section 3-418.

Moreover, it is inescapable from Section 3-417, the "major exception" to the final payment rule (804 F.2d at 1497), that the Code drafters made a deliberate decision to place on payor banks the risk of loss from payments mistakenly made to holders in due course in the face of insolvency. They did so by *not* requiring a presenter to warrant lack of knowledge of insolvency to a payor (Section 3-417(1)) while in the same section they did require a transferor to warrant lack of knowledge of insolvency to his transferee. (Section 3-417(2))(e).

Thus, a court should not carve out a judicial exception to a statute where the Code drafters rejected such exception as clearly as they did here. Indeed, a grave danger is inherent in such a practice for, if a court may make a judicial exception for knowledge of insolvency proceedings (a matter expressly covered in the Section 3-417(2) warranties but rejected in the Section 3-417(1) exceptions), another court may carve other judicial exceptions for other circumstances included in subsection 2 but not in subsection 1 of Section 3-417 (*e.g.*, after-acquired knowledge of defenses on the instrument (*see*, Section 3-417(2)(d)). And if a court may add judicial exceptions for matters which are included in subsection 2 but not in subsection 1 of Section 3-417, it may even more easily add additional judicial exceptions for matters not included in either subsections 1 or 2 (such as, after acquired knowledge of claims to the instrument on the part of other persons).

There is literally no end to the series of judicial exceptions that could then be grafted to the statutory final payment rule, with the result that the exception will become the rule. Holder in due course status will become

meaningless. Were this to occur, the stability of commercial paper would be gravely undermined. As it stands now, a holder in due course who receives payment knows that his payment is at risk for only three limited and statutorily specified circumstances. The potential of an unlimited list of other circumstances, yet to be described in the future by other courts, would have a chilling effect upon the transferability and fluidity of commercial paper. The doctrine of finality of payment, which protects a holder in due course from having to return payment, would be defeated.

Dated: May 7, 1987.

Respectfully submitted,

FRESHMAN, MARANTZ, ORLANSKI,
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GRANT K. RILEY

Attorneys for Defendant/Appellee/
Petitioner American Savings
and Loan Association

APPENDIX A

MORGAN GUARANTY TRUST COMPANY OF NEW YORK,
a New York Corp.,
Plaintiff,
v.
AMERICAN SAVINGS AND LOAN ASSOCIATION,
a California Corp.,
Defendant.

AMERICAN SAVINGS AND LOAN ASSOCIATION,
a California Corp.,
Third-Party Plaintiff,
v.
The CHASE MANHATTAN BANK, N.A.,
Third-Party Defendant.

No. CV-83-6925-AHS.

United States District Court,
C.D. California

March 26, 1985.

OPINION AND ORDER GRANTING SUMMARY JUDGMENT

STOTLER, District Judge.

SUMMARY

This action involves two bearer notes issued by plaintiff Morgan Guaranty Trust Company of New York (hereinafter, Morgan), each in the sum of $5,000,000 and evidencing an indebtedness of the Manville Corporation (hereinafter, Manville). The notes were purchased by defendant American Savings and Loan Association (hereinafter, American) when the maturity date was less than

two months away. Before maturity, however, Manville filed a petition for bankruptcy which invoked the stay provisions of the Bankruptcy Act. On the date of maturity, American, through its agent, third-party defendant Chase Manhattan Bank, N.A. (hereinafter, Chase), presented the two Manville notes to plaintiff for payment. Plaintiff paid the $10,000,000, notwithstanding special measures which had been instituted by it to monitor all Manville negotiable instruments.

Plaintiff filed suit to recover the $10,000,000, alleging counts of conversion, unjust enrichment, and money had and received. Defendant answered and later filed a third-party claim against Chase on the theory that Chase may have agreed, purportedly on American's behalf, to repay plaintiff, but was without authority to do so.

Morgan and American brought cross-motions for summary judgment, while Chase filed a motion to dismiss the complaint for failure to state a claim upon which relief can be granted. American then moved for partial summary judgment on the same issues raised by Chase.

The major question presented by these motions is whether, in a transaction governed by the Uniform Commercial Code, a bank which mistakenly pays on notes covered by insufficient funds has any right of restitution against a payee who presented the notes as a holder in due course.

The Court concludes that the Uniform Commercial Code compels a holding that the "final payment rule" embodied in U.C.C. § 3–418 bars recovery by a plaintiff on its claims for equitable relief.

Judgment in favor of defendant is granted.

FACTS

The facts necessary to resolution of these motions are not in dispute.

On July 8, 1982, defendant American purchased from Goldman, Sachs & Co. (hereinafter, Goldman, Sachs) two promissory notes of the Manville Corporation, each with a face value of $5,000,000 and each made payable on September 2, 1982 at plaintiff Morgan. The notes were delivered by Goldman, Sachs to Chase, which debited American's account by the $9,760,833.33 purchase price of the notes, paid the sum to Goldman, Sachs, and held the notes for American until their maturity.

On August 26, 1982, Manville filed a Chapter 11 petition in bankruptcy.[1] Morgan, which held several Manville accounts, immediately effected special procedures to process the notes it anticipated would be presented on those accounts. The procedures were designed to ensure proper disposition on each and every check presented in compli-

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[1]The filing invoked the automatic stay provisions of 11 U.S.C. Section 362, which provides:

> (a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302 or 303 of this title . . . operates as a stay, applicable to all entities, of —
>
> * * *
>
> (3) any act to obtain possession of property of the estate or of property from the estate
>
> * * *
>
> (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title . . .

Concomitantly, the Bankruptcy Court issued a restraining order similar, in pertinent part, to the Section 362 stay.

ance with the applicable New York Clearing House rules, and to involve bankruptcy counsel in all payment decisions. In the days following the Chapter 11 filing, Morgan received into these channels hundreds of items drawn by Manville. Many were timely returned unpaid, many others were paid despite Manville's bankruptcy and despite the fact that payment caused an overdraft.

On September 2, 1982, without specific instruction from American, Chase presented the Manville notes to Morgan through the New York Clearing House 2:00 a.m. exchange. At that time, the aggregate of available funds in all of Manville's accounts was only $1,398,282.60.

When the Manville notes passed through the New York Clearing House check exchange[2] they became subject to the Clearing House rules. Under these rules, notes presented through the 2:00 a.m. exchange are subject to provisional settlement at 10:00 a.m. that same day. Once made, the provisional settlement can be revoked in one of only two ways: first, the settling bank may physically return the notes to the presenter before 3:00 p.m. that day; second, the settling bank may inform the presenter before 3:00 p.m. that the notes will be dishonored and return the notes through the 11:00 p.m. exchange. Rule 6b, Rules Governing the Return of Items Received through the Exchange of the New York Clearing House. The Morgan employees who usually handled such notes were wellversed in the Clearing House rules and deadlines. However, the special channels established by Morgan to handle the Manville accounts bypassed these employees and instead put the Manville notes in the hands of employees unfamiliar with these rules.

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[2]Morgan and Chase are members. American is not.

At 10:00 a.m. in the morning of September 2, Morgan effected a provisional settlement of $10,000,000 in Chase's favor. In accordance with Morgan's procedures, the Manville notes were forwarded to Cathleen O'Daniel, who, as head of Morgan's Deposit Accounting Department, was responsible for monitoring the Manville accounts. O'Daniel tried twice between 10:00 and 12:00 that morning to contact David Deming, a Morgan official, for instruction in dealing with the notes. Deming, in turn, attempted contact with special counsel handling the Manville bankruptcy procedures for Morgan. Deming ultimately received instructions not to honor the Manville notes. Unfortunately, O'Daniel did not receive her reply until 4:00 p.m.— well past the 3:00 p.m. deadline for dishonoring such notes — when Deming told her to "bounce" the notes. O'Daniel immediately undertook to do so, but it was then too late.

On September 3, Chase transferred the $10,000,000 credit to American's account and notified American of the transaction. On the same day, Morgan demanded repayment of the $10,000,000, first from Chase as agent for American, and then from American itself. American refused to return the payment.

On October 26, 1983, Morgan filed a complaint against American, asserting causes of action for (1) conversion, (2) unjustment enrichment, and (3) money had and received. American answered, and, on May 4, 1984, filed a third-party complaint against Chase seeking indemnity in the event that American would be found liable on any promise, made by Chase as its agent, to return the money to Morgan.

American and Morgan subsequently filed cross-motions for summary judgment. Chase filed a motion to dismiss the complaint under Fed.R.Civ.P. 12(b)(6). American

further moved for partial summary judgment on the complaint in support of the very issues raised in Chase's motion. All motions were presented and heard contemporaneously, but only the cross-motions for summary judgment are considered in this opinion.

DISCUSSION

American has moved for summary judgment as to all three claims of Morgan's complaint. Summary judgment is properly granted where there is no genuine issue of material fact and the moving party in entitled to judgment as a matter of law. Fed. R.Civ.P. 56; *Aydin Corp. v. Loral Corp.*, 718 F.2d 897, 902 (9th Cir.1983).

1. *Unjust Enrichment and Money Had and Received (Claims 2 and 3)*[3]

American posits four alternative theories why Morgan has no equitable right to recover its money paid and, thus, why Claims 2 and 3 — for unjust enrichment and money had and received — must be dismissed: first, that Morgan's payment on the Manville notes was not the result of a "mistake," but was instead voluntary[4]; second, that by

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[3]The parties appear to agree that the dispute on Claims 2 and 3 is governed by the law of New York.

[4]If Morgan had paid the notes voluntarily rather than by mistake, it would be ineligible for equitable relief. *See, e.g., Demos v. Lyons*, 151 N.J. Super. 489, 376 A.2d 1352 (1977). American argues that Morgan actually volunteered payment in the hope that Manville would reimburse them later. Alternatively, American argues that Morgan constructively volunteered payment on the notes by allowing the notes to pass into the hands of employees ignorant of the deadlines rather than those who were familiar with them.

With regard to the first argument, American has presented no evidence that Morgan formed a conscious plan to pay the notes and

signing the notes as agent at the date of their issuance, Morgan accepted the notes and assumed an independent obligation to pay as guarantor[5]; third, that even if the payment was the result of Morgan's mistake of fact, New York common law has never allowed equitable recovery of such payments[6]; and, fourth, even if such recovery were

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seek repayment. To the contrary, all evidence indicates that Morgan knew that Manville would be unable to pay on the notes and that the failure to meet the 3:00 p.m. deadline was inadvertent. With regard to the second argument, American's discussion is primarily based on contract law. At least some courts have indicated that a party will not be denied equitable relief though its error was caused by its own negligence if, in fact, the error was made in good faith. *Gulf Oil v. Lone Star Producing Co.*, 322 F.2d 28 (5th Cir.1963).

[5]American's argument seems to be that Morgan, by signing the notes on the date of their issuance, immediately became independently obligated to the holder. However, the primary case upon which American relies, *Dziurak v. Chase Manhattan Bank, N.A.*, 44 N.Y.2d 776, 406 N.Y.S.2d 30, 377 N.E.2d 474 (1978) is inapposite to this case. *Dziurak* involved a cashier's check, an instrument on which one bank can be both drawer and drawee. The court merely held that the issuing bank had already accepted the check as drawer at the time of issuance. In contrast, the instant case involves a liability that ran from Manville to American, made payable through Manville's account at Morgan.

[6]American cites *Manufacturers Hanover Trust Co. v. Aetna Life & Casualty Co., N.Y.L.J., April 12, 1984*, at 2, col. 1 (N.Y.Co. April 12, 1984) as support for this argument. *Manufacturers* is inapposite to the instant case because the court there found that the bank had volunteered payment with the expectation that it would recover its payment from the debtor. Because there was no mistake of fact concerning the payment — only a unmaterialized hope that the debtor would pay — the court found that there could be no action for restitution.

Other New York cases support the contention that a holder in due course has a duty to repay when he has reason to know that a payment was made by mistake. *See, e.g., Manufacturer's Trust Co. v. Diamond*, 17 Misc.2d 909, 186 N.Y. S.2d 917, 919 (N.Y. Sup.Ct. 1959)

permitted at common law in New York, that the New York Uniform Commercial Code bars all equitable recovery of such payments. Because the Court finds the fourth argument dispositive, resolution of the merits of the other arguments is unnecessary.

American's argument centers on Section 3-418 of the New York U.C.C., which provides:

> Except for recovery of bank payments as provided in the Article on Bank Deposits and Collections (Article 4) and except for liability for breach of warranty on presentment under the preceding section, payment or acceptance of any instrument is final in favor of a holder in due course, or a person who has in good faith changed his position in reliance on the payment.

The parties dispute the effect of the section and the circumstances under which that effect is brought to bear on a commercial transaction. Morgan contends that the preconditions to application of Section 3-418 have not been met in this case. Morgan further argues that, if the section does apply to this case, that the N.Y.U.C.C. preserves common law restitutionary rights for a bank that has mistakenly paid on an NSF note. American responds that this transaction falls within the ambit of Section 3-418, and that the section acts to bar restitutionary recovery of a final payment by Morgan.

a. *Criteria for Application of Section 3-418*

By its terms, Section 3-418 requires that two conditions be met before the "final payment" rule takes effect. First, there must be a "payment or acceptance." Second,

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("There is no reason why a bank . . . should be denied recovery of money paid by mistake in circumstances which would justify recovery by anyone else.").

the payment must be in favor of a holder in due course of good faith relier.

(1) *Payment*

[1] The "payment" referred to in Section 3-418 is defined in N.Y. U.C.C. Section 4-213:

> (1) An item is finally paid by a payor bank when the bank has done any of the following, whichever happens first:
>
> * * *
>
> (d) made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, clearing house rule or agreement.

As discussed above, Morgan made a provisional settlement for the Manville notes at 10:00 a.m. on September 2, as specified by the New York Clearing House Check Exchange Rules; it failed to revoke the settlement by the 3:00 p.m. deadline provided by those same rules. Thus, the notes were "finally paid."[7]

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[7]As Morgan and American point out in their papers, there has been some difference of opinion concerning the meaning of Section 4-213. Some authorities have concluded that Section 4-213 announces a rule of final payment, barring all restitutionary actions for monies "finally paid." *See Kirby v. First & Merchants National Bank*, 210 Va. 88, 91 n. 4, 168 S.E.2d 273 (1969); *and* J. White and R. Summers. Handbook of the Law Under the Uniform Commercial Code (2d Ed.1980), Section 16-4. Others have concluded that the section does not bar actions in restitution, but marks the point at which a superior equitable right must be asserted by the payor to regain possession of the payment. *See National Savings and Trust Co. v. Park Corp.*, 722 F.2d 1303 (9th Cir.1983), *cert. denied.* ____U.S. ____, 104 S.Ct. 1916, 80 L.Ed.2d 464 (1984); *and Demos v. Lyons*, 151 N.J. Super. 489, 492, 376 A.2d 1352 (1977) ("The moment when payment has

(2) *Holder in Due Course*

"Holder in due course" in defined in N.Y. U.C.C. Section 3-302:

> (1) A holder in due course is a holder who takes the instrument
>
> (a) for value; and
>
> (b) in good faith; and
>
> (c) without notice that is overdue or has been dishonored or of any defense against or claim to it on the part of any person.
>
> (2) A payee may be a holder in due course.

[2] The parties agree that, when American took the notes on July 8, 1982, is became a holder in due course: American paid full value for the notes and had no reason to know that Manville soon would be filing in bankruptcy.[8] Yet Morgan apparently argues that American lost its status as holder in due course by allowing Chase to present the notes on September 2 with full knowledge of Manville's intervening bankruptcy filing and the stay that automatically became effective on that filing. *See* 11 U.S.C. Section 362.

Unfortunately for Morgan, there is nothing in Section 3-302 or elsewhere in the Code that indicates that a person can be stripped of his status as a holder in due

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thus become 'finalized' [under 4-213] often becomes important to establish priorities or to establish when the payor must have a prevailing equity to get back the money."). Since Section 3-418 is also applicable to this case, however, the Court need not consider whether Section 4-213 announces the final payment rule.

[8] Manville's Chapter 11 filing apparently came without warning to those outside the company. Morgan concedes that American could not have had notice on July 8, 1982, that any such filing was imminent.

course by subsequent events. Indeed, Section 3-302 by its terms considers only the circumstances extant at the time of taking. It is thus irrelevant for purposes of Section 3-418 that American and/or Chase may have learned after the July 8, 1982, purchase of the notes of Manville's August 26, 1982, Chapter 11 filing.

b. *Effect of Section 3-418*

[3] American contends that Section 3-418 bars restitutionary action on a note finally paid to a holder in due course. Morgan, noting that N.Y.U.C.C. Section 1-103 authorizes the use of equitable principles available at common law "[u]nless displaced by the particular provisions of this Code," counters that Section 3-418 does not displace equitable rights of recovery for a payment made under a mistake of fact.[9]

Morgan cites four cases in support of its contention. The first two, *Demos v. Lyons,* 151 N.J.Super. 489, 376 A.2d 1352 (1977), and *National Savings and Trust Co. v. Park Corp.,* 722 F.2d 1303 (9th Cir. 1983), *cert. denied,* ___ U.S. ___, 104 S.Ct. 1916, 80 L.Ed.2d 464 (1984), do nothing to help Morgan's case. *Demos* involved a dispute among a payee bank, the bank's customer who had written an NSF check, and the presenter of the check. The presenters concededly had not taken the check for value and acknowledged that "they were not holders in due course and did not change their position in reliance on the payment." 151 N.J.Super. at 495, 376 A.2d 1352.

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[9]N.Y.U.C.C. Section 1-103 provides in full: Unless displaced by the particular provisions of this Code, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.

Since the defendants had not met the threshold requirements of Section 3-418, the *Demos* court never even reached the issue of the possible effect of the section on that transaction.

The *Park* case similarly provides no support. There, as in *Demos,* the court began its analysis by finding that the payee was not a holder in due course. Indeed, the court reasoned that the payor had a restitutionary right *only* because "no value had been given [by the payee] for the instrument." 722 F.2d at 1306.

The final two cases cited, *Bank Leumi Trust Co. v. Bally's Park Place, Inc.,* 528 F.Supp. 349 (S.D.N.Y.1981), and *Greater Western Bank & Trust v. Nahat,* 138 Ariz. 260, 674 P.2d 323 (Ariz.App.1983), although somewhat ambiguous, ultimately provide no more support for Morgan's position. *Bank Leumi* involved a recovery action by a payor bank that mistakenly paid an NSF check. The court allowed the payor to maintain its action, announcing that:

> [Section 3-418 applies] to interbank settlement procedures, and not to subsequent actions for restitution. A contrary reading . . . would be inconsistent with Section 1-103, which retains the common law governing mistake. It would lead to the unintended result of allowing a payee, unjustly, to retain monies improperly obtained.

528 F.Supp. at 354.

Read by itself, this passage seems to indicate that Section 3-418 has no effect on any action for restitution. But closer examination of the *Bank Leumi* decision indicates that the discussion of Section 3-418 is limited to the case of a payee who is not a holder in due course. Indeed, the parties apparently did not argue the issue, and the court observed in a footnote:

> Concepts having to do with bona fide holders of negotiable paper in due course without notice are not involved in this litigation. See New York U.C.C. Section 3-302.

528 F.Supp. at 350, n. 1. The *Bank Leumi* payee, then, could not avail himself of the protections of Section 3-418, since he could not show that he met its threshold requirements.

Like *Bank Leumi*, *Nahat* involved a restitutionary action by a bank that mistakenly paid on a check that the payee suspected was NSF. Reviewing the case on appeal from summary judgment for the defendant, the court found that a restitutionary action might properly be maintained if the payee was not a holder in due course. The court apparently remanded to determine whether the defendant had ever attained the status of holder in due course. Only if he had would summary judgment be appropriate: "The U.C.C. guarantees that an innocent holder, i.e., a holder in due course, is assured payment on an instrument if it is not dishonored within the statutory period." 138 Ariz. at 265, 674 P.2d 323. The *Nahat* court, like those in *Demos*, *Park*, and *Bank Leumi*, did not proceed beyond the threshold question of whether the payee was a defendant contemplated by the language of Section 3-418, and thus did not consider the import of that section.

More persuasive is the position urged by American: even if New York allowed restitutionary recovery of such payments at common law, the drafters of Section 3-418 have ensured that a drawee bank that pays on a forged or NSF check now has "a rocky road to restitutionary recovery." J. White and R. Summers, Handbook of the Law Under the Uniform Commercial Code (2d Ed.1980) Section 16-2, p. 610. Eschewing a more liberal policy

toward equitable relief, they adopted instead the common law doctrine of *Price v. Neal*, 3 Burr. 1354 (1762), "under which a drawee who accepts or pays an instrument on which the signature of the drawer is forged is bound on his acceptance and cannot recover his payment." Official Comment 1 to U.C.C. Section 3-418.

The rule of finality announced in *Price v. Neal* and embraced by the drafters of Section 3-418 has been justified by several policies, two of which are cited in the official comments. First, the "traditional justification . . . is that the drawee is in a superior position to detect a forgery" or an NSF check because he has the drawer's signature or information regarding the status of the drawer's account. Official Comment 1 to U.S.C. § 3-418. The rule also facilitates the practical operation of the banking industry because it allows the parties to end "the transaction on an instrument when it is paid rather than reopen and upset a series of commercial transactions at a later date." *Id.* Accordingly, Section 3-418 furthers the underlying goal of the U.C.C. to safeguard "the interest of society in an orderly banking system, with the rights and liabilities of participants in the world of finance spelled out in advance." 1 Andersen, Uniform Commercial Code, Section 1-102:46 (3d Ed.1981).

Whatever the justification, however, one thing is clear: because of Section 3-418, a drawee that pays "an NSF check will sometimes have to absorb that loss itself and will often have no cause of action against the party who presented the check." White & Summers, Handbook, Section 16-10. *See Marine Midland Bank v. Umber*, 96 Misc.2d 835, 410 N.Y.S.2d 25 (1978); *Northern Trust Co. v. Chase Manhattan Bank, N.A.*, 582 F.Supp. 1380 (S.D.N.Y. 1984); *National Savings and Trust Co. v. Park Corp.*, 722 F.2d 1303 (9th Cir.1983), *cert. denied*, ____

U.S. ____, 104 S.Ct. 1916, 80 L.Ed.2d 464 (1984). Here, the rule of finality bars Morgan's equitable claims against American for return of money paid out.

2. *Conversion (Claim 1)*

[4] Morgan's first claim for relief is for conversion. The claim is based solely on American's refusal, despite Morgan's demand, to return the $10,000,000 paid on the notes.[10] American is entitled to judgment on this claim as a matter of law.

[5, 6] Under New York law, a cause of action for conversion will lie where (1) the plaintiff can demonstrate legal ownership or an immediate superior right of possession to a specific identifiable thing, and (2) the defendant has exercised unauthorized dominion over the thing, to the exclusion of the plaintiff. *AMF Inc. v. ALGO Distributors, Inc.*, 48 A.D.2d 352, 369 N.Y.S.2d 460, 464 (1975). In this case, Morgan has not demonstrated legal ownership or a superior right of possession to the $10,000,000. When Morgan paid on the Manville notes, it paid as a drawee of the notes. It has failed to demonstrate that it retained any

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[10]A preliminary issue is whether New York or California law governs the claim for conversion. Morgan argues that California law governs because the alleged conversion took place in California. However, few, if any, of the events in this transaction took place outside of New York. The presentment of the notes took place in New York between two New York banks, and the transaction was recorded on the accounts of the banks in the Federal Reserve Bank of New York. Only after the transaction between Chase and Morgan was consummated did Chase transfer the $10,000,000 credit to American's California account. The alleged conversion therefore took place in New York. Furthermore, the choice of law provisions in the N.Y.U.C.C. favor application of New York law. N.Y.U.C.C. Section 4-102(2) provides that the law for determining the liability of a payor bank shall be the law of the forum in which the bank resides.

legal right or, as discussed above, any equitable right to the money paid out. Nor has it any right of possession superior to American's.

[7] Moreover, Morgan has not shown that there is any "specific identifiable thing" in this case that can be the subject of a conversion. The transactions at issue were conducted by means of an electronic sorting system which apportions credits and debits at the close of each day's business cycle and registers each member bank as payee or payor. Morgan's money thus was not the subject of a specifically identifiable fund capable of being converted. A "mere claim for moneys paid out by mistake" will not support an action for conversion under New York law. *Northern Trust Co. v. Chase Manhattan Bank, N.A.*, 582 F.Supp. 1380, 1386 (S.D.N.Y. 1984); *Marine Midland Bank v. John E. Russo Produce Co.*, 65 A.D.2d 950, 410 N.Y.S.2d 730, 733 (4th Dep't 1978), *modified on other grounds*, 50 N.Y.2d 31, 405 N.E.2d 205, 427 N.Y.S.2d 961 (1980).

DISPOSITION

Defendant's motion for summary judgment is granted. Plaintiff's motion for summary judgment is denied. The third-party claim of American is dismissed. Chase's motion to dismiss is moot as is American's motion for partial summary judgment.

The Clerk is directed to enter judgment in favor of defendant and against plaintiff.

APPENDIX B

MORGAN GUARANTY TRUST COMPANY
OF NEW YORK,
a New York corporation,
Plaintiff-Appellant,

v.

AMERICAN SAVINGS AND LOAN ASSOCIATION,
a California corporation,

Defendant-Third Party-Plaintiff-Appellee,

and

The Chase Manhattan Bank, N.A.,
Third Party Defendant-Appellee.

No. 85-5817.

United States Court of Appeals,
Ninth Circuit.

Argued and Submitted Feb. 7, 1986.

Decided Nov. 26, 1986.

Before FLETCHER, NELSON, and HALL, Circuit Judges.

FLETCHER, Circuit Judge:

[1] Morgan Guaranty Trust Company of New York appeals from the district court's grant of summary judgment in favor of American Savings & Loan Association and Chase Manhattan Bank on Morgan's claims for unjust enrichment, money had and received, and conversion. This appeal centers around a question of first impression: whether a holder-in-due-course is entitled to retain funds mistakenly paid to it on notes presented after the holder

has knowledge that the maker of the notes has filed a petition for bankruptcy. We hold that it is not so entitled, and reverse in part.

BACKGROUND

The material facts of the case are undisputed. On July 8, 1982, American purchased two Manville Corporation bearer notes due and payable September 2, 1982, at Morgan, each with a face value of $5 million. The notes were held for American by Chase until maturity.

On August 26, 1982, Manville filed a Chapter 11 petition in bankruptcy. In response to the filing, Morgan, which held several Manville accounts, instituted special procedures to process Manville notes and checks. American, aware of the bankruptcy, did not anticipate payment of the notes on September 2.

On September 2, Chase, acting without instructions from American, presented the notes to Morgan through the New York Clearing House 2:00 a.m. exchange.[1] Morgan effected a provisional settlement of $10 million for the notes at 10:00 a.m. that day. Under Clearing House rules, once the provisional settlement was made, Morgan could revoke it only by taking action before 3:00 p.m. the same day.

Morgan processed the notes in accordance with its special procedures for dealing with Manville paper. Unfortunately, the employees in the special channels were unfamiliar with Clearing House procedures. By the time bankruptcy counsel had been consulted and the decision

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[1]At that time, there was less than $2 million in available funds in Manville's accounts at Morgan.

to dishonor the notes was conveyed, it was 4:00 p.m., too late to revoke the settlement.

The next day, Chase transferred $10 million credit to American. Morgan demanded repayment of the money, first from Chase, then from American. American refused to return the money.

Morgan filed this action against American. American filed a third-party complaint against Chase seeking indemnity if American should be found liable on a promise by Chase, acting as its agent, to return the money to Morgan. American and Morgan filed cross-motions for summary judgment and Chase filed a motion to dismiss for failure to state a claim. American then moved for partial summary judgment on the issues raised in Chase's motion. All motions were presented and heard together.

The district court granted American's motion for summary judgment. *Morgan Guaranty Trust Co. v. American Savings & Loan Assoc.*, 605 F.Supp. 1086 (C.D.Cal. 1985). The court found Morgan's claims for unjust enrichment, and money had and received, barred by section 3-418 of the New York Uniform Commercial Code. 605 F.Supp. at 1090-93. It found that the action for conversion would not lie because Morgan had not established any legal or equitable right to the money and because there was no specific, identifiable fund capable of being converted. *Id.* at 1094.[2] Morgan timely appeals.

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[2]Because of its decisions on the summary judgment motions, the court dismissed American's third-party claim against Chase and dismissed Chase's motion as moot. 605 F.Supp. at 1094.

STANDARD OF REVIEW

We review a grant of summary judgment *de novo*. *Ashton v. Cory*, 780 F.2d 816, 818 (9th Cir.1986). Where the facts are undisputed, we confine our inquiry to whether the district court correctly applied the relevant substantive law. *See id.*

DISCUSSION

I.
PRESENTMENT AND THE AUTOMATIC STAY

When Manville filed its petition in bankruptcy, it triggered the automatic stay provisions of 11 U.S.C. § 362(a) (1982).[3] Actions taken in violation of the automatic stay are void. *Sambo's Restaurants, Inc. v. Wheeler (In re Sambo's Restaurants, Inc.)*, 754 F.2d 811, 816 (9th Cir.1985). Subsection 362(a)(6) stays "any act to collect, assess, or recover a claim against the debtor that arose before [the filing of the petition]." Morgan argues that Chase's presentment of the notes was an act to collect a claim against Manville, and therefore violated subsection 362(a)(6), and was void.

If the presentment had taken place today, clearly the automatic stay would not void it. 11 U.S.C. § 362(b)(10) (Supp.1984) exempts from the stay the presentment of negotiable instruments. However, subsection 362(b)(10) applies only to cases filed after October 8, 1984, *see* Pub.L. 98-353, § 553(a) (1984), so it does not govern this case. We must decide whether the automatic stay prohib-

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[3]The bankruptcy court issued an order applying the provisions of section 362(a) to Manville and its property. We assume, since it used the same language, that the court intended the scope of the stay to be identical to the statutory provisions.

ited presentment prior to that date. We conclude that it did not.

[2-4] Subsection 362(a)(6) uses very broad language and courts generally construe the automatic stay provisions broadly. *See, e.g., Coben v. Lebrun* (*In re Golden Plan of California, Inc.*), 37 B.R. 167, 170 (Bankr.E.D.Cal.1984); *Wallingford's Fruit House v. Inhabitants of the City of Auburn* (*In re Wallingford's Fruit House*), 30 B.R. 654, 659 (Bankr.D.Me.1983). However, the language of the other provisions of the automatic stay suggests that mere requests for payment are not barred absent coercion or harassment by the creditor. These provisions stay acts that immediately or potentially threaten the debtor's possession of its property: commencement of judicial proceedings; enforcement of judgments; creation and enforcement of liens; and setoffs of debts owing to the debtor against claims against the debtor. 11 U.S.C. §§ 362(a)(1, (2), (4), (5), (7) & (8). The activities that are specifically prohibited all involve attempts to confiscate the debtor's property or require the debtor to act affirmatively to protect its interests. Presentment and other requests for payment unaccompanied by coercion or harassment do not appear to fall within the prohibitions of section 362(a).

The reasons for the automatic stay also suggest that it does not bar presentment. The statute seeks to ensure orderly administration of the debtor's estate to protect the creditors' right to equality of distribution, *see Superior Paint Manufacturing Co. v. Lopez-Soto* (*In re Lopez-Soto*), 764 F.2d 23, 27 (1st Cir.1985); *Holtkamp v. Littlefield* (*In re Holtkamp*), 669 F.2d 505, 508 (7th Cir.1982); Sen.Rep. No. 989, 95th Cong., 2d Sess. at 49 (1978); *reprinted in* 1978 U.S.Code Cong. & Ad.News 5787, 5835; H.Rep. No. 595, 95th Cong. 1st Sess. at 340 (1977),

reprinted in 1978 U.S.Code Cong. & Ad.News 5787, 6297; *see also First National Bank of Anchorage and Alaska Title Guaranty Co. v. Roach* (*In re Roach*), 660 F.2d 1316, 1318–19 (9th Cir. 1981); to provide a breathing spell for the debtor, *Roach*, 660 F.2d at 1318; H.Rep. No. 595 at 121, *reprinted in* 1978 U.S.Code Cong. & Ad.News at 6082; and to maintain the status quo, *Roach*, 660 F.2d at 1319; *United States v. Sayres*, 43 B.R. 437, 439 (W.D.N.Y.1984); *United Mutual Savings Bank v. Doud* (*In re Doud*), 30 B.R. 731, 734 (Bankr. W.D.Wash.1983). An additional purpose of the stay, to which Congress specifically addressed subsection 362(a)(6), is to prevent harassment of the debtor by sophisticated creditors. Sen.Rep. No. 989 at 50–51, *reprinted in* 1978 U.S.Code Cong. & Ad.News at 5836–37; H.Rep. No. 595 at 125–26, 342, *reprinted in* 1978 U.S.Code Cong. & Ad.News at 6086–87, 6298; *see Roach*, 660 F.2d at 1318; *Brown v. Pennsylvania State Employees Credit Union* (*In re Brown*) 49 B.R. 558, 561 (Bankr.M.D.Penn.1985).

[5] Voiding the presentment of notes of a bankrupt maker does not appear to further any of these purposes. The mere act of presentment does not interfere with orderly administration of the estate, the debtor's "breathing spell," or the status quo. Presentment cannot be characterized as harassment, particularly where the creditor presents its notes to the payor bank, rather than to the debtor. *See Brown*, 49 B.R. at 561 (letter from credit union to debtor violated automatic stay when sent directly to debtor rather than to his attorney). We conclude that the language and purposes of section 362(a) do not bar mere requests for payment unless some element of coercion or harassment is involved.[4] *Cf. Roach*, 660 F.2d

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[4]The case law supports a distinction between communications between the creditor and debtor that contain threats or harassment

at 1318–19 (bank's notice of postponement of sale of debtor's property specifying new date does not violate automatic stay where bank did not "harass, interfere, or gain any advantage").

[6] Our conclusion that presentment did not violate the automatic stay prior to the enactment of subsection 362(b)(10) is buttressed by the legislative history of the subsection. Congress intended the subsection to be a

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and those that merely set forth the fact that money is owing. Thus, courts have held the automatic stay violated by letters giving notice of intent to terminate a lease, *Southside Leasing Co. v. Merchant's Plaza, Inc.* (*In re Merchant's Plaza, Inc.*), 35 B.R. 888, 893–94 (Bankr.D.Tenn.1983); *see A. Dan Chisolm, Inc. v. B.P. Oil, Inc., Gulf Products Division* (*In re A. Dan Chisolm, Inc.*), 57 B.R. 718, 720 (Bankr.M.D.Fla.1986) (notice of intent to terminate franchise may violate stay); by a letter informing the debtor that a creditor medical clinic would provide no future medical services due to his refusal to pay, *Olson v. McFarland Clinic* (*In re Olson*) 38 B.R. 515, 517–18 (Bankr.N.D.Iowa 1984), by a letter from an attorney informing the debtor he had been retained by a creditor to collect a delinquent account, *DeLay v. Underwood* (*In re DeLay*), 25 B.R. 898, 901 (Bankr.W.D.Mo.1982) *modified on other grounds*, 48 B.R. 282 (W.D.Mo.1984); by a college that refused to give transcripts to the debtor to force payment, *Parraway v. Andrews University*, 50 B.R. 316, 319 (W.D.Mich.1984) (collecting cases), and by a creditor who made repeated visits and telephone calls to the debtor. *In re Gibson*, 16 B.R. 682, 683–84 (Bankr.S.D.Ohio 1981). On the other hand, a court has said that a letter from a credit union announcing it would do no further business with the debtor unless the debt was reaffirmed would not have violated the automatic stay if it had been sent to the debtor's attorney, *Brown*, 49 B.R. at 561, and we have treated other communications that merely set forth the fact of the debt as amendable proofs of claim not voided by the automatic stay, *see Sambo's Restaurants*, 754 F.2d at 816; *County of Napa v. Franciscan Vineyards, Inc.* (*In re Franciscan Vineyards, Inc.*) 597 F.2d 181, 182–83 (9th Cir.1979) (per curiam), *cert. denied*, 445 U.S. 915, 100 S.Ct. 1274, 63 L.Ed.2d 598 (1980).

clarifying amendment, not a change in the law.[5] Although such subsequent legislative history is not conclusive, we are entitled to give it weight when the meaning of the statute and original congressional intent are in doubt. *Seatrain Ship Building Corp. v. Shell Oil Co.*, 444 U.S. 572, 596, 100 S.Ct. 800, 813, 63 L.Ed.2d 36 (1980).

Morgan points to no cases holding that section 362(a) bars a creditor's request for payment unaccompanied by coercion or harassment. In light of this absence of authority, the language and purposes of the stay provisions, and the subsequent legislative history, we hold that the presentment of the Manville notes did not violate the automatic stay.

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[5]In 1980, the language of subsection 362(b)(10) was first introduced as part of a bill "to correct technical errors, clarify and make minor substantive changes" to the Bankruptcy Reform Act of 1978. *See* H.Rep. No. 1195, 96th Cong.2d Sess.1(1980). The House Judiciary Committee called the provision "a confirming amendment to make clear that the automatic stay is not intended to interfere with the rights of a holder of a negotiable instrument to obtain payment." *Id.* at 11. Though the 1980 bill was never enacted, each chamber passed its own version of the bill including the presentment provision, and the limited record of discussion indicates no controversy about the provision. *See* 126 Cong. Rec. 26,485 *et seq.* (House version of bill and discussion), 31,139 *et seq.* (Senate version of bill and discussion) (1980). When the provision was adopted in 1984, Congress used identical language. We think that this legislative history gives some indication that, as early as 1980, Congress did not intend the automatic stay to affect presentment of negotiable instruments. *See Montana Wilderness Association v. U.S. Forest Service*, 655 F.2d 951, 957 (9th Cir.1981) (subsequent conference report entitled to significant weight), *cert. denied*, 455 U.S. 989, 102 S.Ct. 1612, 71 L.Ed.2d 848 (1982).

II.

RESTITUTION UNDER NEW YORK COMMON LAW

Morgan argues that even if presentment of the Manville notes was proper, it has an equitable right to return of the money. American counters that equity does not provide a remedy for Morgan's careless payment and, even if there is a remedy, it has been displaced by the Uniform Commercial Code. We first address the availability of equitable remedies.

New York[6] allows actions for unjust enrichment or money had and received to recover money paid by mistake where it would be inequitable for the payee to retain the money. *See Paramount Film Distributing Corp. v. State*, 30 N.Y.2d 415, 421, 285 N.E.2d 695, 698, 334 N.Y.S.2d 388, 393 (1972), *cert. denied*, 414 U.S. 829, 94 S.Ct. 57, 38 L.Ed.2d 64 (1973); *In re Leland Fox & John Murphy, Inc.*, 111 A.D.2d 972, 490 N.Y.S.2d 71, 72 (1985). The payor may recover even if it was negligent, *Castock Corp. v. Bailey*, 128 Misc.2d 1068, 492 N.Y.S.2d 921, 922 (Sup.1985); *Citibank v. Warner*, 113 Misc.2d 748, 449 N.Y.S.2d 822, 823 (Sup.1981); *see McGrath v. Hilding*, 41 N.Y.2d 625, 630, 363 N.E.2d 328, 332, 394 N.Y.S.2d 603, 607 (1977) (plaintiff can recover even if guilty of "grievous misconduct" if enrichment sufficiently unjust); unless the payee has changed its position in reliance on the mistaken payment, *Castock*, 492 N.Y.S.2d at 922; *Manufacturers Hanover Trust Co. v. Akpan*, 91 Misc.2d 622, 398 N.Y.S.2d 477, 479 (N.Y.City Civ.Ct. 1977); *see Paramount Film*, 30 N.Y.2d at 421, 285 N.E.2d at 698, 334 N.Y.S.2d at 393.

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[6]The parties agree that New York law applies to the claims for unjust enrichment and money had and received.

New York courts have allowed restitutionary actions for payments "by mistake" in a wide variety of circumstances, some of which appear to involve simple carelessness. *See, e.g., Stark v. City of New York*, 23 Misc.2d 721, 198 N.Y.S.2d 547, 549 (Sup. 1960) (plaintiff paid taxes in mistaken belief he owned lot); *Citibank*, 113 Misc.2d 748, 449 N.Y.S.2d 822, 823 (bank mistakenly credited funds to wrong account); *Manufacturers Trust Co. v. Diamond*, 17 Misc.2d 909, 186 N.Y.S.2d 917, 918–19 (Sup. 1959) (per curiam) (bank paid check drawn on closed account); *Blue Cross of Central New York v. Wheeler*, 93 A.D.2d 995, 461 N.Y.S.2d 624, 626 (1983) (insurance company paid on lapsed policy); *Allcity Insurance Co. v. Bankers Trust Co.*, 80 Misc.2d 899, 364 N.Y.S.2d 791, 794 (Alb.Co.Ct.1975) (same). In *Manufacturers Trust Co. v. Diamond*, the court found it unnecessary to determine the precise factual circumstances surrounding the bank's honoring a check drawn on a closed account; it merely stated that it was "self-evident that but for a mistake the plaintiff would not have paid the check . . . ." 186 N.Y.S.2d at 918. It appears that any unintentional result can be categorized as a "mistake".

[7] The case that best demonstrates the breadth that New York courts give the mistaken payment theory of recovery is *Valley Bank of Nevada v. Bank of Commerce*, 74 Misc.2d 195, 343 N.Y.S.2d 191 (N.Y.City Civ.Ct.1973). In *Valley Bank*, a forged check drawn on the defendant was deposited with the plaintiff's predecessor-in-interest, the Bank of Las Vegas. After paying the check, the defendant discovered the forgery, and requested repayment from the Bank of Las Vegas. Although the court found that under the U.C.C. the defendant had no right to the money, 343 N.Y.S.2d at 193, Bank of Las Vegas paid. When its depositor refused to reimburse it, Bank of Las Vegas realized its mistake and sued defendant to recover the

money. The court held that Bank of Las Vegas could recover whether its error was characterized as a mistake of fact (it may have believed its depositor would not object to being charged with funds to cover the forged check) or a mistake of law (it may have believed defendant had a valid claim). *Id.* at 194–195. The court stated that because Bank of Las Vegas paid a claim on the basis of a mistake of fact or law and the payee "received a windfall which in fairness it should not be allowed to retain," the court would grant restitution. *Id.* at 195. We believe that *Valley Bank* demonstrates that if a bank mades a payment, however carelessly, and the payee has no right to the money, New York courts will order return of the mistaken payment unless the payee has changed its position.

[8] Applying New York's unjust enrichment analysis to the case before us, we have no trouble concluding that Morgan has an equitable right to restitution. It is "self-evident" that Morgan made some sort of mistake when it failed timely to dishonor the notes. Whether this error is characterized as mistake of fact or law is irrelevant under New York law. Once Manville filed its petition in bankruptcy, American had no right to receive payment on the notes until the proper disposition of Manville's estate was determined. Because American had no right to the money, Morgan is entitled to restitution unless American changed its position in reliance on the mistaken payment. American has made no showing of changed position, and we do not think it could. It had no reasonable expectation of receiving the money and Morgan notified it of the mistake immediately. We conclude that a New York court would not allow American to retain the $10 million windfall and would provide restitution to Morgan absent a statutory bar.

[9] American argues that because Morgan's payment was voluntary, Morgan cannot get equitable relief. *See, e.g., Armco, Inc. v. Southern Rock, Inc.*, 696 F.2d 410, 412 (5th Cir.1983). *Demos v. Lyons*, 151 N.J.Super. 489, 376 A.2d 1352, 1355 (1977). We disagree. A voluntary payment is one made "by design or intentionally or purposefully or of one's own accord or by the free exercise of the will." *Gulf Oil Corp. v. Lone Star Producing Co.*, 322 F.2d 28, 31 (5th Cir.1963) (quoting *Prigmore v. Hardware Mutual Ins. Co.*, 225 S.W.2d 897, 899 (Tex.Civ.App.1949)). Morgan's failure to dishonor, which came about through careless failure to educate its employees as to deadlines, hardly fits this definition. *See Morgan*, 605 F.Supp. at 1090 n. 4 (all evidence indicates Morgan's failure to dishonor was "inadvertent"). The payment made in *Valley Bank* was more nearly "voluntary" than that made by Morgan, yet the New York court awarded restitution.

American argues, however, that Morgan should be treated as a volunteer because its mistake was the result of "conscious ignorance." Under the conscious ignorance doctrine, parties that have entered a contract or made payments knowing that they were uncertain of material facts are barred from claiming resulting mistakes as a basis for equitable relief. *See Southern National Bank of Houston v. Crateo, Inc.*, 458 F.2d 688, 693 (5th Cir.1972); *Aluminum Company of America v. Essex Group, Inc.*, 499 F.Supp. 53, 68 (W.D.Penn.1980); *Backus v. MacLaury*, 278 A.D. 504, 106 N.Y.S.2d 401, 404 (1951); *Harley v. Magnolia Petroleum Co.*, 378 Ill. 19, 37 N.E.2d 760, 765 (1941); Restatement of Contracts 2d § 154, comm. e. For example, a pipe manufacturer that funded repairs on leaky pipes conscious of the fact that it did not know who was responsible for the leaks cannot claim mistake as

grounds for restitution when it later discovers the installer was at fault. *Armco*, 696 F.2d at 412–13.

[10] The conscious ignorance doctrine encourages parties to investigate before they act. Equity will not aid someone who deliberately forgoes an opportunity to discover material facts. *See Harley*, 37 N.E.2d at 765–66; *see also In re North Broadway Funding Corp.*, 34 B.R. 620, 623 (Bankr. E.D.N.Y.1983) (equity should not intrude "to relieve a party from the foreseeable consequences of a conscious course of action"). However, American asks us to bar recovery because Morgan became aware, as the deadline flew by, that it did not know what the deadline was. Morgan never made a conscious decision to proceed in the face of insufficient information. We find the conscious ignorance doctrine inapplicable to this case. Because we find that Morgan would have an equitable remedy under New York law, we must determine whether that remedy has been displaced by the U.C.C.

III.

DISPLACEMENT AND THE UNIFORM COMMERCIAL CODE

We begin our analysis of the effect of the U.C.C. on Morgan's right to restitution with section 1–103[7] which the leading commentators on the Code have called its most important provision. J. White & R. Summers, *Handbook of the Law Under the Uniform Commercial Code* 19 (2d ed. 1980) (*"Handbook"*). Section 1–103 provides:

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[7]All statutory citations in this section refer to the U.C.C. For clarity, we use the U.C.C. numbering system when referring to provisions of the N.Y.U.C.C. or the Code as enacted in other jurisdictions.

> Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.

The drafters specifically intended that courts would use equitable principles and section 1-103 to create exceptions to U.C.C. provisions. *See Handbook* at 19; Summers, *General Equitable Principles Under Section 1-10-3 of the Uniform Commercial Code*, 72 Nw.U.L.Rev. 906, 941 (1978) ("Principles"). Judges have a duty to consider the equities of a case unless equitable principles have been displaced, *Principles* at 908, 909, and "nothing short of an express code provision limiting plaintiff's remedy" demonstrates displacement, *Hechter v. New York Life Insurance Co.*, 46 N.Y.2d 34, 39, 385 N.E.2d 551, 554, 412 N.Y.S.2d 812, 815 (1978); *see Handbook* at 19.

American contends, and the district court held, that section 3-418 explicitly displaces Morgan's restitutionary remedy. Section 3-418 provides:

> Except for recovery of bank payments as provided in the Article on Bank Deposits and Collections (Article 4) and except for liability for breach of warranty on presentment under the preceding section, payment or acceptance of any instrument is final in favor of a holder in due course, or a person who has in good faith changed his position in reliance on the payment.

Morgan does not contend that American breached a warranty or that any provision of Article 4 gives it a right to restitution. It also concedes that American is a holder

in due course. Consequently, our inquiry is whether 3–418 was intended to bar a restitutionary remedy to a payor bank against a holder in due course that had knowledge of the bankruptcy of the maker at the time the instrument was presented. We find nothing in the comments to the section or the case law to suggest that the question was ever considered by the drafters.

Section 3–418 was intended to codify the rule of *Price v. Neal*, 3 Burr. 1354, 97 Eng. Reprint 871 (1762), under which a drawee that accepts or pays an instrument on which the signature of the drawer is forged cannot recover from an innocent payee. Section 3–418, comment 1. The bank was said to be responsible for knowing the authentic signatures of its customers and having the means to compare them with the signature on the instrument. *Id.; Marine Midland Bank v. Umber*, 96 Misc.2d 835, 410 N.Y.S.2d 25, 27 (Alb.Co.Ct.1978). Another rationale for the rule is to promote finality of transactions: "it is highly desirable to end the transaction on an instrument when it is paid rather than reopen and upset a series of commercial transactions at a later date when the forgery is discovered." Section 3–418, comment 1; *Marine Midland*, 410 N.Y.S.2d at 27.

The provision has been applied in forgery cases, *Northern Trust Co. v. Chase Manhattan Bank*, 583 F.Supp. 1380, 1386 (S.D.N.Y.), *aff'd* 748 F.2d 803 (2d Cir.1984) (per curiam); *Marine Midland*, 410 N.Y.S.2d at 27; *Aetna Life & Casualty Co. v. Hampton State Bank*, 497 S.W.2d 80, 85-86 (Tex.Civ.App.1973), as well as in cases where instruments were paid despite insufficient funds or stop payment orders, *Lowe's of Sanford v. Mid-South Bank & Trust Co.*, 44 N.C.App. 365, 260 S.E.2d 801, 802-03 (1979); *Bryan v. Citizens National Bank in Abilene*, 628 S.W.2d 761, 763-64 (Tex. 1982). Extension to the latter situations

was contemplated by the drafters, and is justified by the same rationales as the *Price v. Neal* rule: the transactions should be final and the bank should be responsible for knowing the condition of its customers' accounts. *See* Section 3-418, comment 2. There are two major differences between the case before us and the cases contemplated by the drafters of 3-418. First, American had notice of the problem with the instrument. Second, the problem was bankruptcy of the maker, not forgery, insufficient funds or a stop order.

Section 3-418, by imposing liability on the party who best can avoid loss, makes perfect sense as a rule to determine which of two innocent parties should bear the loss. However, if both parties to a transaction know that the payee is not entitled to payment on an instrument, the rationales behind 3-418 are inapplicable. The payee who receives payment aware that he is not entitled to it does not have the same expectation of finality as an innocent payee and the payor bank in this circumstance does not have superior knowledge. A party who accepts payment on an instrument knowing that the payor was entitled to dishonor it justifiably receives less favorable treatment by a court of equity than a payee ignorant of any problem. *See Farmers & Merchants Bank v. Universal C.I.T. Credit Corp.*, 4 Utah 2d 155, 289 P.2d 1045, 1049 (1955) (pre-U.C.C. case approving restitution where payee knows there are insufficient funds to cover check). American points to no cases applying section 3-418 to bar recovery from a payee who had notice that the payor had reason to dishonor the instrument. *But see* section 3-417, comment 4 (suggesting that, in absence of bad faith, a holder in due course that knowingly presents a forged instrument is entitled to keep money mistakenly paid on it).

The second distinguishing factor about this case is that the maker filed a petition in bankruptcy. The district court characterized this as an insufficient funds case. *Morgan,* 605 F.Supp. at 1088. We disagree. Unlike defendants in insufficient funds cases, who generally have rights against the maker or drawer of the instrument, American had no right to any recovery from Manville until the proper distribution of Manville's estate was determined. The absence of such rights also distinguishes this case from stop payment and forgery cases. The payee of a check subject to a stop order often has a present right to recover against the drawer. If it does not have such a right, the payor bank can assert the drawer's rights and recover the mistaken payment. *See* section 4–407; *Savings Banks Trust Co. v. Federal Reserve Bank,* 577 F.Supp. 964, 967 (S.D.N.Y.), *aff'd* 738 F.2d 573 (2d Cir.1984) (per curiam); *Admiral Leather Corp. v. Manchester Modes, Inc.,* 422 F.Supp. 387, 390 (S.D.N.Y.1976). Forgery cases generally arise between an innocent collecting bank and an innocent payor bank, *see, e.g., Northern Trust,* 582 F.Supp. 1380, both of whom have a present right to recover from the forger.

The fact that the holder of a note of a bankrupt maker has no present right of recovery makes the equitable balance different from that in other section 3–418 cases. A payee with no present right to payment is differently situated than a party who is entitled to money but cannot receive it because of the state of the drawer's account or the unavailability of a culpable forger.

In addition, one of the primary goals of the bankruptcy laws is to provide for equality of treatment among creditors. *Elliott v. Frontier Properties (In re Lewis W. Shurtleff, Inc.),* 778 F.2d 1416, 1420 (9th Cir.1985); *England v. Industrial Commission of Utah (In re Visiting Home Ser-*

vices, Inc.), 643 F.2d 1356, 1360 (9th Cir.1981); *see Simonson v. Granquist*, 369 U.S. 38, 40, 82 S.Ct. 537, 538, 7 L.Ed.2d 557 (1962). Allowing American to retain its windfall, derived solely from Moran's mistake, puts it in a better position than similarly situated creditors. Although there is no provision of the bankruptcy laws that prohibits American from keeping the money, we would further the goal of equality of treatment by allowing restitution. Our point is not as the dissent would have it, that "This result is required by operation of federal bankruptcy law," but that bankruptcy policy is an additional equitable consideration favoring Morgan's position. *Cf. McKnight;* 769 F.2d at 662 (awarding restitution to avoid creating preference in favor of defendants over other creditors).

[11] We conclude that 3–418 does not displace a restitutionary action by a payor bank for recovery of a mistaken payment to a payee with knowledge of the bankruptcy of the maker of the instrument in question. *Met Frozen Food v. Nat'l Bank of America*, 89 Misc.2d 1033, 393 N.Y.S.2d 643 (1977), cited by the dissent is not inconsistent with our holding. In *Met*, there were no allegations either that plaintiff was not entitled to receive payment at the time the bank attempted to dishonor the checks or that plaintiff knew that the checks should be dishonored. Moreover, the bank's reason for dishonoring the checks was *not* the bankruptcy of the depositor; the bankruptcy took place *after* the bank attempted to dishonor the checks. See 393 N.Y.S.2d at 646, 648. Nor is there any indication in the case that the bank knew of the impending bankruptcy when it attempted to dishonor.[8]

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[8]Counsel's argument addressed by the court in *Met Frozen Foods* noted in footnote 3 of the dissent was directed to an entirely different issued. Defendant bank in that case argued that plaintiffs *had not*

The fact that American is a holder in due course adds to the equitable balance on its side, but, on balance, does not overcome the equities in Morgan's favor.

[12] In cases closely analogous to the one at bar, defendants have been allowed recovery of mistaken payments. When a payee discovers before presenting an instrument that its maker has died he becomes a general creditor of the estate of the deceased and has no right to payment until the proper disposition of assets has been determined. *Bank Leumi Trust Co. of New York v. Bally's Park Place, Inc.*, 528 F.Supp. 349, 354 (S.D.N.Y.1931). The only case applying 3-418 in the context of the death of the maker found that 3-418 did not bar recovery of a mistaken payment from a payee with knowledge. *Id.* at 354. Similarly, holders of cashier's checks drawn on an insolvent bank become creditors of the bank and can receive payment only in compliance with the National Bank Act. *FDIC v. McKnight*, 769 F.2d 658, 661 (10th Cir.1985), *cert. denied*, ____ U.S.____, 106 S.Ct. 1184, 89 L.Ed.2d 300 (1986). When an insolvent bank's receiver mistakenly honored cashier's checks, the Tenth Circuit held 3-418 inapplicable and ordered restitution. *Id.* Though these cases are not controlling,[9] they support our

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been damaged by its failure timely to dishonor because if the money had been paid, it would have to have been returned as a voidable preference due to the subsequent bankruptcy. *See* 393 N.Y.S.2d at 648. Defendants did not argue either that the plaintiffs had no right to payment at the time of dishonor or that plaintiffs knew of the impending bankruptcy at the time the checks were presented. The court correctly determined that it was not the proper forum for determining the rights of the parties that arose from the subsequent bankruptcy, *id.*, but did not address the equitable arguments at issue in this case.

[9] *Bank Leumi* expressly stated that it did not involve holders in due course. 528 F.Supp. at 350 n. 1. Furthermore, the court emphasized

conclusion that 3–418 does not bar restitution when the payee has actual knowledge that it has no present right to receive payment. See *Bank Leumi*, 528 F.Supp. at 355 ("the burden of pursuing the estate of the maker should fall on the depositor of a check known to be worthless, rather than the drawee-bank guilty of computer-induced negligence in failing to protest the check in timely fashion.").

American argues that the warranty provisions of section 3–417 demonstrate that the drafters of the code explicitly desplaced a restitutionary remedy against a payee with knowledge of bankruptcy. The 3–417 warranties are a major exception to the final payment rule of 3–418. Under 3–417(2)(e), when a party transfers an instrument for value, it warrants that it has no knowledge of insolvency proceedings instituted with respect to the maker. By contrast, the presentor of an instrument makes no such warranty. *See* section 3–417(1). American concludes from section 3–417 that the drafters, by not requiring a payee to warrant lack of knowledge of insolvency proceedings to a payor bank, made a deliberate decision to place the risk of loss from payments mistakenly made despite insolvency on the payor bank. Thus, it argues, a payee's knowledge of insolvency proceedings cannot form the basis of an equitable action. We read section 3–417

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that the defendant should have known that the check it deposited was in a form that could give problems to the payor bank. *Id.* at 353. Thus the case can be viewed as turning on the bad faith of the defendant. *See* F. Miller & A. Howell, *The Law of Modern Payment Systems and Notes* 221 n. 51 (1985).

In *McKnight*, the court also found that the checks were converted from negotiable instruments to deposits by operation of law at the moment of insolvency. 769 F.2d at 661; *see* 12 U.S.C. § 1813(l)(4)(1982). *McKnight* also obviously involves a different statutory scheme than the bankruptcy laws.

differently. Section 3-511(3)(a) provides that a payee with knowledge of the insolvency of the maker of an instrument *need not* present the instrument to preserve the rights that ordinarily are lost if timely presentment is not made. Section 3-511(3)(a) and comment 6. If the payee has knowledge of the bankruptcy, normally it will not present the instrument. The drafters had no reason to anticipate that the situation in this case would arise. On the other hand, there is no reason for the holder of a note of an insolvent maker not to transfer the instrument. For the protection of the transferee, the holder, who generally is in a better position to know of any insolvency proceedings, must warrant that it is not aware of them when it transfers the note. See section 3-417 comment 10. We conclude that the different treatment accorded to payor banks and transferees by section 3-417 was designed to protect transferees, not to assign the risk of loss in a situation the drafters had no reason to anticipate. Consequently, we remain unconvinced that the drafters specifically considered the effect of 3-418 on a payee with knowledge of bankruptcy.

American also contends that carving out "judicial exceptions" to the final payment rule of section 3-418 will "have a chilling effect upon the transferability and fluidity of commercial paper." This argument ignores section 1-103, which mandates equitable exceptions to the Code, and fails to recognize the narrowness of our holding. The case we decide today apparently has not arisen before and we think it unlikely that it will recur often enough to undermine seriously the operation of the nation's financial markets. The dissent similarly argues that our opinion will undermine the finality of commercial transactions. Contrary to the dissent's views, courts could not engage in this kind of analysis in every case to reach results they find "equitable". The vast majority of cases

that implicate section 3-418 involve forgeries, insufficient funds or stop payment orders. They understandably are governed by the final payment rule. We believe that individual consideration under section 1-103 of the rare cases that involve situations apparently not contemplated by the drafters is merited and will not undermine the basic operation of section 3-418 or render "the Rules of the New York Clearing House mere verbiage."

American also argues that the delay provision of the Code, section 4-108, bars a restitutionary action by Morgan. The applicable portion of the provision, section 4-108(2), provides,

> Delay by a collecting bank or payor bank beyond time limits prescribed or permitted by this Act or by instructions is excused if caused by interruption of communication facilities, suspension of payments by another bank, war, emergency conditions or other circumstances beyond the control of the bank provided it exercises such diligence as the circumstances require.

The provision is applicable to delays in processing items governed by clearing house rules. Section 4-108 comment 4.

American alleges that the delay in dishonoring the Manville notes was not caused by circumstances beyond Morgan's control and that Morgan did not exercise the diligence required by the situation. It claims that section 4-108 operates as the only means to excuse delay, and since its terms are not met, Morgan is liable for failure to dishonor the notes on time. We disagree.

[13] Section 4-108(2) on its face expands, rather than limits, the ability of payor banks to avoid liability by payments caused by unintentional failure to dishonor. It

says that "delay is excused if caused by" then listed occurrences, not that delay is *only* excused by them. Comment 4 to the section says "*when delay is sought to be excused under this subsection* the bank must 'exercise such diligence as the circumstances require' and it has the burden of proof." Section 4–108, comment 4 (emphasis added). This language persuades us that a payor can excuse delay in other ways. Nothing in the language of the statute, the comments to it, or the cases cited by American suggests that 4–108 was intended to displace equitable remedies preserved elsewhere in the Code.

[14] American cites *Union Bank of Benton v. First National Bank,* 621 F.2d 790, 795 (5th Cir.1980), for the proposition that in the absence of an excuse for late return, the payor bank is held strictly liable for the item. *Union Bank* involved the deadlines set by section 4–302. *Id.* Courts have universally held that payor banks are strictly liable for violation of 4–302 deadlines. *See State & Savings Bank of Moticello v. Meeker,* 469 N.E.2d 55, 58 (Ind.App.1984) (collecting cases). However, section 4–302 does not apply to this case.[10] The relevant deadlines come from clearing house rules and section 4–213.[11]

[15] Courts are divided on the effect of finality of payment under section 4–213. Some courts have held that

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[10]Section 4–302(a) applies to demand items; the Manville notes were not demand items, but rather payable on a specific date. Section 4–302(b) applies to "properly payable items." The notes were not properly payable because Manville funds were not available for payment at the time Morgan had to decide whether to honor them. Section 4–104(1)(i).

[11]Section 4–213 provides in pertinent part,

An item is finally paid by a payor bank when the bank has done any of the following

* * *

once a payment is final under the provision, the payor is liable to the presentor for the face value of the instrument and has no possible equitable action for return of money paid by mistake. *See, e.g., Ashford Bank v. Capital Preservation Fund, Inc.*, 544 F.Supp. 26, 29 (D.Mont.1982). This view is flawed in that it ignores the fact that section 3–418 clearly was intended to leave unjust enrichment actions available in some situations. Other courts have found that finality under 4–213 has no independent substantive effect, but merely determines when section 3–418 comes into play. *See National Savings and Trust Co. v. Park Corp.*, 722 F.2d 1303, 1306 (6th Cir.1983), *cert. denied*, 466 U.S. 939, 104 S.Ct. 1916, 80 L.Ed.2d 464 (1984); *Demos*, 376 A.2d at 1356–57. We think this is the better view. There is no evidence that section 4–213 was intended to displace the principles of restitution for mistaken payments that survive section 3–418. *See Demos*, 376 A.2d at 1357.

> At no point does any comment to section 4–213 mention the effect this section is supposed to have on the restitutionary rights of banks. Thus, it seems evident that the drafters of the Code never intended for section 4–213 to supercede section 3–418, and we can see no reason to adopt a position contrary to that intent.

National Savings, 722 F.2d at 1306. The New York cases relied on by the dissent simply do not address the relationship between sections 4–213 and 3–418.

(d) made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by the statute, clearing house rule or agreement.

Upon a final payment under subparagraphs (b),(c) or (d) the payor bank shall be accountable for the amount of the item.

Section 4–301, relied on by the dissent, is inapplicable to this case. That section applies, by its terms, only to demand items; the note at issue here was not a demand item.

We conclude that sections 3–418, 4–108 and 4–213 do not displace Morgan's equitable remedy for payment by mistake.[12] We reverse the district court's grant of summary judgment for American and remand to allow the court to enter judgment for Morgan on its claims for unjust enrichment and money had and received.

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[12]American also argues that Morgan "accepted" the Manville notes by signing them, and thereby agreed to be primarily liable. *See* section 3–410. However, it is apparent from the face of the notes that this claim must fail. Printed on the notes above the signature of Morgan's authorized agent is a statement which reads,

PAYABLE AT Morgan Guaranty Trust
Company
23 Wall Street
New York, N.Y. 10015

NOT VALID UNLESS COUNTERSIGNED BY MORGAN GUARANTY TRUST COMPANY OF NEW YORK AS ISSUING AGENT.

This makes clear that the purpose of the signature was to verify the notes, not to assume liability for them. American relies on *Dziurak v. Chase Manhattan Bank*, 58 A.D.2d 103, 396 N.Y.S.2d 414, 416 (1977), *aff'd* 44 N.Y.2d 776, 377 N.E.2d 474, 406 N.Y.S.2d 30 (1978), for the proposition that a bank's signature can have two purposes. American argues that Morgan's signature on the notes was both as acceptor and drawee. *Dziurak*, however, involved a cashier's check, an instrument which by definition is accepted upon issuance. 396 N.Y.S.2d at 415–16. A bank's signature on such an instrument necessarily is serving two purposes. *Dziurak* does not support construing a signature potentially made as an issuing agent as an acceptance.

IV.

CONVERSION AND PUNITIVE DAMAGES

Because we have granted Morgan relief for unjust enrichment and money had and received, the remaining conversion claim would be superfluous in the absence of Morgan's request for punitive damages based on that claim. The parties disagree on whether New York or California law applies and on whether Morgan can state a claim for conversion of money that was received through the netting of electronic fund transfers.[13] We need not decide these issues, however, because we find that punitive damages would be inappropriate under either New York or California law.

[16] Punitive damages must be based on a showing of conscious disregard for the rights of others or some type of evil motive or other morally culpable conduct. *See Welch v. Mr. Christmas, Inc.*, 57 N.Y.2d 143, 150, 440 N.E.2d 1317, 1321, 454 N.Y.S.2d 971, 975 (1982); *Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 354, 358, 353 N.E.2d 793, 795, 386 N.Y.S.2d 831, 833 (1976); *Borkowski v. Borkowski*, 39 N.Y.2d 982, 355 N.E.2d 287, 387 N.Y.S.2d 233 (1976); Cal.Civ.Code § 3294 (West 1970); *Hasson v. Ford Motor Co.*, 32 Cal.3d 388, 402, 650 P.2d 1171, 1179–80, 185 Cal.Rptr. 654, 662–63 (1982), *cert. dismissed*, 459 U.S. 1190, 103 S.Ct. 1167, 75 L.Ed.2d 422 (1983); *Colonial Life*

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[13]Although the parties acknowledge that only specifically indentifiable money can be the subject of a conversion action, *see Peters Griffin Woodward, Inc. v. WCSC Inc.*, 88 A.D.2d 883, 452 N.Y.S.2d 599, 600 (1982); *Weiss v. Marcus*, 51 Cal.App.3d 590, 599, 124 Cal.Rptr. 297, 303 (1975), it is unclear how this standard would apply to the case at bar. *Compare Limbaugh v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 732 F.2d 859, 862–63 (11th Cir.1984) *with Northern Trust Co. v. Chase Manhattan Bank*, 582 F.Supp. 1380, 1386 (S.D.N.Y.), *aff'd*, 748 F.2d 803 (2d Cir.1984) (per curiam).

& Accident Insurance Co. v. Superior Court, 31 Cal.3d 785, 792, 647 P.2d 86, 90, 183 Cal.Rptr. 810, 814 (1982). American retained the $10 million in this case under a tenable claim of right strong enough to convince the district court. Although we reverse, we acknowledge that this is a close case and that the key issue is one of first impression. Punitive damages are inappropriate in this case. *See Hollender v. Trump Village Cooperative*, 97 A.D.2d 812, 468 N.Y.S.2d 683, 685 (1983) (punitive damages inappropriate where no showing of moral culpability or evil motive) *Fox v. Aced.*, 49 Cal.2d 381, 317 P.2d 608, 610 (1957) (punitive damages not recoverable against party who acts in good faith under advice of counsel). In the absence of a viable claim for punitive damages, Morgan's conversion claim is superfluous and we need not address it.

CONCLUSION

We reverse the district court's grant of summary judgment in favor of American, and remand with instructions to enter summary judgment for Morgan on its claims for unjust enrichment and money had and received. American's third party complaint against Chase was premised on American being held liable as the result of promises made by Chase to Morgan. Because we find American liable due to its own unjust retention of funds mistakenly paid to it, we affirm the district court's dismissal of American's claim against Chase.

AFFIRMED in part, REVERSED and REMANDED in part.

CYNTHIA HOLCOMB HALL, Circuit Judge, dissenting:

Today a majority of the panel holds that a bank which fails to dishonor notes by the deadline established by the local clearing house rule and which makes payment on the notes to a holder in due course may recover those payments in cases when the Uniform Commercial Code does not specifically refer to the fact situation involved and when a court determines that it is "equitable" to grant relief. I believe that the Code was intended to provide more concrete guidance for those engaging in commercial paper transactions.

I agree that section 1-103 of the Code provides the background for interpreting other Code provisions and I agree that the equitable principles embodied in that section govern transactions unless displaced. The majority's definition of "displacement," however, basically forges a rule that allows courts to disregard Code provisions in the pursuit of their view of equity whenever the letter of the Code leads to a result they view as unpalatable. The majority states the purposes behind the final payment rule of section 3-418 and then engages in a long discourse of how the peculiar and myriad facts of this case weaken or distinguish the policies behind the rule. I have no doubt that courts could engage in this kind of analysis in every case to reach results they find "equitable." The ultimate result of this process, however, is an unfortunate uncertainty in commercial transactions, an uncertainty that the Code was designed to avoid.

Broad rules intended to guide a large number of commercial transactions reflect policy judgments. Often those judgments require what may seem to be harsh results in individual cases in order to achieve a greater policy objective along with a certainty in law which allows all to

conform their conduct to the requirements of the rule. The final payment rule of section 3-418 is no different. This rule is intended to provide for finality in commercial paper transactions so that the integrity of those transactions can be maintained. *See* 6 R. Anderson, *Uniform Commercial Code* § 3-418:4, at 412 (3d ed. 1984) (footnote omitted) ("UCC § 3-418 is predicated upon the need for finality and not upon any outdated concept that the drawee bank can carefully examine checks for forgery."). This policy, and not any factual permutations that might have been considered by the Code's drafters, designates the point at which notions of equity are supplanted.

The majority believes that, because American knew that Morgan had the right to dishonor the notes, American had a reduced expectation of finality and, as a result, section 3-418 does not apply. I find no indication that the goal of finality to which section 3-418 is directed is at all linked to any expectations of finality of a party to the transaction. The principle is inextricably linked to the expectations not only of the instant parties but to the millions of future parties whose conduct must conform to section 3-418 and who must know its limits to conform to its guidelines. The majority may feel that it has made a small, limited incursion into section 3-418's domain. Other parties will be left to wonder whether this case is a one-way ticket good for this day and this day only or an indication of other future "limited" incursions.

Sections 3-418 and 4-213 make clear that courts should make no incursion at all. Comment 5 to section 3-418 states (emphasis added):

> [The final payment rule] is . . . limited by the bank collection provision (Section 4-301) permitting a payor bank to recover a payment improperly paid if it returns the item or sends notice of dishonor within

the limited time provided in that section.[14] *But notice that the latter right is sharply limited in time, and terminates in any case when the bank has made final payment, as defined in Section 4-213.*

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[14]U.C.C. § 4-301 provides:

(1) Where an authorized settlement for a demand item (other than a documentary draft) received by a payor bank otherwise than for immediate payment over the counter has been made before midnight of the banking day of receipt the payor bank may revoke the settlement and recover any payment if before it has made final payment (subsection (1) of Section 4-213) and before its midnight deadline it

(a) returns the item; or

(b) sends written notice of dishonor or nonpayment if the item is held for protest or is otherwise unavailable for return.

* * *

(3) Unless previous notice of dishonor has been sent an item is dishonored at the time when for purposes of dishonor it is returned or notice sent in accordance with this section.

(4) An item is returned:

(a) as to an item received through a clearing house, when it is delivered to the presenting or last collecting bank or to the clearing house or is sent or delivered in accordance with its rules. . . .

Comment 5 to section 4-301 states that if the item has been "finally paid" under section 4-213 (1), then section 4-301 "has no operation."

Section 4–213 of the Code specifies the time at which the right to revoke payment expires. That rule provides (emphasis added):

> (1) An item is finally paid by a payor bank when the bank has done any of the following, whichever happens first:
>
> (a) paid the item in cash; or
>
> (b) settled for the item without reserving a right to revoke the settlement and *without having such right under statute, clearing house rule or agreement;* or
>
> * * *
>
> (d) made a provisional settlement for the item and *failed to revoke the settlement in the time and manner permitted by statute, clearing house rule or agreement.*

The equitable principles of section 1–103 have their place in commercial paper transactions, but those equitable rights expire when the clearing house deadline expires. The Code provided Morgan with a right to recover any money it paid before the deadline so long as the revocation of payment occurred within the time allowed by the clearing house rules. Unfortunately, the provisional settlement in American's favor became final when the deadline passed.

Any other result renders the language of section 4–213 meaningless. When sections 4–213(1)(b) and (d) speak of revocation, we must assume that they refer to revocation for legitimate reasons, and Morgan certainly had a legitimate reason for revoking any provisional settlement in American's favor. Morgan had every right to refuse to pay on the note. But even legitimate efforts to revoke have

their time limitations, as the plain language of section 4-213 makes apparent. After that time has passed, the policy favoring finality cuts off the equitable rights in order to further the goal of repose. *See Perini Corp. v. First National Bank*, 553 F.2d 398, 405-06 (5th Cir.1977).

The majority states that it believes the interaction of sections 3-418 and 4-213 can be viewed in either of two ways and that it favors the view that section 4-213 does not extinguish restitutionary rights. *Ante* at 1499 (citing *National Savings and Trust Co. v. Park Corp.*, 722 F.2d 1303, 1306 (6th Cir.1983), *cert. denied*, 466 U.S. 939, 104 S.Ct. 1916, 80 L.Ed.2d 464 (1984)). Neither I nor the courts of New York, whose law we are bound to apply, think that the majority's view of section 4-213 is the better view. A bank that fails "to dishonor the check before the deadline provided by the Uniform Commercial Code and the Rules of the New York Clearing House" may not recover its payments. *Fromer Distributors, Inc. v. Bankers Trust Co.*, 37 A.D.2d 840, 321 N.Y.S.2d 428, 430 (Sup.Ct.1971) (citing U.C.C. §§ 4-211, 4-213, & 4-301). That payment is final. 321 N.Y.S.2d at 430. *See Manufacturers & Traders Trust Co. v. County Trust Region of the Bank*, 59 A.D.2d 645, 398 N.Y.S. 298, 298 (Sup.Ct.1977) (citing U.C.C. §§ 4-301 & 4-302). *Cf. Security Trust Co. v. First National Bank*, 79 Misc.2d 523, 358 N.Y.S.2d 943, 945, 947 (Sup.Ct.1974) (defendant bank not liable on checks since return was timely pursuant to the clearing house rules and proper notice was given under Code).

In *Met Frozen Food Corp. v. National Bank of North America*, 89 Misc.2d 1033, 393 N.Y.S.2d 643 (Sup.Ct.1977), the court explained the difficult policy decisions accompanying the burdens placed upon payor banks. The requirement that payor banks comply with clearing house rules or face liability for the amount of the

notes places those banks in a "precarious position." 393 N.Y.S.2d at 647. The payor bank "must act and act quickly under rather hectic conditions to protect itself against incurring substantial liabilities. However, the integrity of the entire system of commerical paper itself requires that someone bear a risk. The UCC has quite logically placed the risk upon the obvious party [the payor bank]." *Id.*[15] Because of the role of the payor bank in the collection process, " '[t]he legislature could have considered that the failure of such a bank to meet its deadline is likely to be due to factors other than negligence, and that the relationship between a payor bank and its customer may so influence its conduct as to cause a conscious disregard of its statutory duty.' " *Id.* at 647-48 (quoting *Rock Island Auction Sales v. Empire Packing Co.*, 32 Ill.2d 269, 273, 204 N.E.2d 721, 723 (1965)).

Finally, the court in *Met Frozen Food* stated the well-established rule of New York law, that a failure to revoke before the clearing house deadline is, in effect, final payment of the item. 393 N.Y.S.2d at 647. This rule held true even though the bank's reasons for attempting to

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[15]The majority argues that *Met Frozen Food* is consistent with its holding. *Ante* at 1496-97. The plain language of the New York court's opinion rebuts this contention:

> It is clear that if the plaintiff can establish that [the payor bank] failed to timely return a check . . .within the deadline set forth in [the Code] . . . [the payor bank] is liable for the face amount of the item . . . less any payment received (*see UCC § 4-213*).

395 N.Y.S.2d at 647 (emphasis added) (citing *Sunshine v. Bankers Trust Co.*, 34 N.Y.2d 404, 358 N.Y.S.2d 113, 314 N.E.2d 860 (1974); *Fromer Distributors*, 321 N.Y.S.2d 438; *Rock Island Auction Sales v. Empire Packing Co.*, 32 Ill.2d 269, 273, 204 N.E.2d 721, 723 (1965); *United States v. Loskocinski*, 403 F.Supp. 75 (E.D.N.Y.1975)).

dishonor the notes included the bankruptcy of its depositor. *Id.* at 648.[16]

The Code and its equitable principles demonstrate some sympathy for those payors who make payment on notes they are entitled to dishonor. But that sympathy goes only so far. After the grace period for recovery of mistaken payments has passed and after the time for dishonor under the clearing house rules has lapsed, the

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[16]The majority implies that the payor bank in *Met Frozen Food* did not argue that the bankruptcy of the depositor precluded liability. *Ante* at 1497 & n.8. Again, the language of the New York court's opinion reveals the majority's error:

> In a rather intriguing argument . . . defendant contends that plaintiffs cannot establish [liability]. It argues that due to the short period of time between dishonor [of the checks] and [the depositor's] *bankruptcy*, plaintiffs would have been unable, *assuming a timely return*, to retain the monies received since payment would represent a voidable preference . . . . However, here, since defendant was a payor bank its obligations were prescribed by [the Code], which, as previously noted, requires return to be made within a specified time. . . .
>
> The issue of whether payment by defendant of the checks in question would result in plaintiffs' [sic] obtaining a preference over [the depositor's] other creditors is not properly before this Court. It has not been established that the defendant is a creditor . . . *nor are these actions the appropriate forum* [sic] *for making such a determination.* That issue may be relevant if and when a recovery is obtained.

393 N.Y.S.2d at 648 (emphasis added). The fact that the bankruptcy occurred after the bank attempted to dishonor the checks in no way alters the analysis. Nor does the majority's assumption that the *bank* lacked knowledge of the impending bankruptcy. In fact, if the bank in *Met Frozen Food* was unaware of the impending bankruptcy of its depositor, it would have had an even stronger case on the "equities." In any event, the New York court found the bankruptcy immaterial to the issues before it.

goal of finality, if it is to mean anything at all, must take priority. The majority's rule raised the possibility that a payor may be entitled to recover a mistaken payment months after payment is made. That possibility creates an uncertainty which undermines the goal of finality in commercial paper transactions. The principle of finality, if it is to be achieved, cannot tolerate such results. Further, the majority's rule has the effect of rendering the Rules of the New York Clearing House mere verbiage.[17]

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[17]I take issue with any implication in the majority opinion that its result is required by operation of federal bankruptcy law. Much is made of the point that if American is allowed to retain the money it will somehow receive favored treatment vis-a-vis other creditors of Manville. First, I believe this argument simply begs the question of who is Manville's creditor. American has received no money from the bankruptcy estate. What has happened in this case, in essence, is that Morgan has purchased American's claim against Manville. Thus, it is Morgan — not American — that is Manville's creditor. *Cf.* note 3 *supra.*

Second, when we have referred to the bankruptcy policy that creditors share equally, we have meant that creditors in the same class or those possessing the same nonbankruptcy entitlements should share equally. But the initial step in this inquiry is to determine the nonbankruptcy entitlements of the creditors. *See Butner v. United States,* 440 U.S. 48, 55, 99 S.Ct. 914, 918, 59 L.Ed.2d 136 (1979); *Ohio v. Kovacs,* 469 U.S. 274, 285, 105 S.Ct. 705, 711, 83 L.Ed.2d 649 (1985) (O'Connor, J., concurring); *In re Anchorage International Inn,* 718 F.2d 1446, *passim* (9th Cir.1983). I believe that American's nonbankruptcy entitlements are greater than those of other unsecured creditors. Because American's nonbankruptcy rights entitle it to full payment, American should be entitled to full payment in bankruptcy.

Finally, no creditor of the debtor is placed in a worse position in order to benefit any other creditor. Because there has been no distribution from estate assets, no unsecured creditor faces a diminished recovery. One creditor has simply been substituted for another. And the size of Morgan's claim against the estate will be of a size

The court in *Met Frozen Food* recognized the significance of destabilizing commercial paper exchanges by weakening the rule of repose.

> $14,835,917,339,000 [is] an impressive amount, even in an age of superlatives. It represents the total dollar value of commercial paper cleared through the sixteen Federal Reserve Banks in the major cities of the United States during the 1975 calendar year. In New York City alone, the average daily exchange at the New York Clearing House amounts to $5,642,306,382.51. Each day, then, more than five billion dollars changes hands in the metropolitan area by means of abstract transactions involving bank debits and credits. . . . [I]n a functional economy paper is king.
>
> This fluidity of exchange is made possible by the country's "banking system." It provides the machinery and the personnel which makes the transfer of funds possible and workable.

393 N.Y.S.2d at 644–45.

There are some areas in which "undefined considerations of equity" have no place. *See Butner v. United States*, 440 U.S. 48, 56, 99 S.Ct. 914, 918, 59 L.Ed.2d 136 (1979). The final payment rule is one of those areas. If I take any solace at all from the decision in this case, it is that our rule does not bind the courts of New York which have clearly marked out a better path to follow.

I dissent.

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equal to that American would have had absent Morgan's mistaken payment. Thus, I see no reason to alter the state law result in this case simply because the maker of the note happens to be in bankruptcy. Although Congress has the authority to upset state law substantive rights, "Congress has not done so." *In re Anchorage International Inn*, 718 F.2d at 1451.

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MORGAN GUARANTY TRUST COMPANY OF NEW YORK
a New York corporation,
Plaintiff-Appellant,

vs.

AMERICAN SAVINGS AND LOAN ASSOCIATION,
A CALIFORNIA CORPORATION,
Defendant-Third Party-Plaintiff-Appellee,

and

THE CHASE MANHATTAN BANK, N.A.,
Third Party Defendant-Appellee.

No. 85-5817
D.C. No. CV 83-6925-AHS

ORDER

Filed: April 6, 1987

BEFORE: FLETCHER, NELSON, and HALL, Circuit Judges.

Judge Fletcher and Judge Nelson have voted to deny the petition for rehearing en banc. Judge Hall voted to grant the petition for rehearing en banc.

The full court has been advised of the suggestion for en banc rehearing, and no judge of the court has requested a vote on it. Fed. R. App. P. 35(b).

The petition for rehearing en banc is denied.

The request to amend the mandate to provide for prejudgment interest is denied without prejudice to appellant's right to seek prejudgment interest on remand.

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

MORGAN GUARANTY TRUST COMPANY OF NEW YORK,
a New York corporation,
Plaintiff-Appellant,

vs.

AMERICAN SAVINGS AND LOAN ASSOCIATION,
A CALIFORNIA CORPORATION,
Defendant-Third Party-Plaintiff-Appellee,

and

THE CHASE MANHATTAN BANK, N.A.,
Third Party Defendant-Appellee.

No. 85-5817
D.C. No. CV 83-6925-AHS

ORDER

Filed: April 17, 1987

BEFORE: FLETCHER, Circuit Judge.

Appellee's request for stay of mandate pending petition for certiorari to the Supreme Court is granted for thirty days from date of this order, pursuant to Rule 41(b) of the Rules of Appellate Procedure.

PROOF OF SERVICE BY MAIL

I am a citizen of the United States and a resident of the City and County of Los Angeles; I am over the age of eighteen years and not a party to the within action; my business address is: 1706 Maple Avenue, Los Angeles, California.

On May 7, 1987, I served the within Petition for Writ of Certiorari in re: "Morgan Guaranty Trust Company of New York vs. American Savings and Loan Association" in the United States Supreme Court, October Term 1986, No.....;

On the Parties in said action, by placing Three copies thereof enclosed in a sealed envelope with postage fully prepaid, in the United States post office mail box at Los Angeles, California, addressed as follows:

Eric L. Dobberteen
Kadison, Pfaelzer, Woodward, Quinn & Rossi
707 Wilshire Blvd., 40th Floor
Los Angeles, CA 90017

Roger A. Ferree
McCutchen, Black, Verleger & Shea
600 Wilshire Blvd., Ste. 1200
Los Angeles, CA 90017

All Parties required to be served have been served.

I certify (or declare), under penalty of perjury, that the foregoing is true and correct.

Executed on May 7, 1987, at Los Angeles, California

CE CE MEDINA

Subscribed and Sworn to before me this day of , 1987.

My Commission Expires _____.

_____

Notary Public